Calendar No. 301

97TH CONGRESS } 1st Session } SENATE { REPORT No. 97-209

BUSINESS ACCOUNTING AND FOREIGN TRADE SIMPLIFICATION ACT

REPORT

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE

TO ACCOMPANY

S. 708

together with

ADDITIONAL VIEWS

OCTOBER 9, 1981.—Ordered to be printed
Filed, under authority of the order of the Senate of October 6, 1981

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OCTOBER 9, 1981.—Ordered to be printed
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Mr. D'AMATO, from the Committee on Banking, Housing and Urban Affairs, submitted the following

REPORT

together with

ADDITIONAL VIEWS

[To accompany S. 708]

The Committee on Banking, Housing and Urban Affairs, to which was referred the bill (S. 708) to amend and clarify the Foreign Corrupt Practices Act of 1977, having considered the same, reports favorably thereon with an amendment and recommends that the bill, as amended, do pass.

COMMITTEE DELIBERATIONS

Senator Chafee introduced S. 708, for himself and 13 cosponsors, on March 12, 1981. Joint hearings on the bill were held before the Subcommittee on Securities and the Subcommittee on International Finance and Monetary Policy on May 20, May 21, June 16, July 23 and July 24, 1981.

The Committee met in open executive session on September 16, 1981 and agreed to report favorably S. 708, with an amendment, in the nature of a substitute, by a vote of 11 yeas to 4 nays.

HEARINGS

The hearings referred to above provided an extensive analysis of the issues addressed by S. 708 from a variety of perspectives. Witness lists and hearings dates were as follows:

May 20, 1981

Honorable William E. Brock, U.S. Trade Representative.
Sherman E. Unger, General Counsel, Department of Commerce.
Edward C. Schmults, Deputy Attorney General, U.S. Department of Justice.
Ernest B. Johnston, Jr., Deputy Assistant Secretary for Economic and Business Affairs, U.S. Department of State.
Donald L. Scantlebury, Director, Accounting and Financial Management Division, General Adcounting Office.

May 21, 1981

Robert McNeill, Executive Vice President, Emergency Committee for American Trade.
Peter Trooboff, Covington and Burling.
John Subak, General Vice President, Rohm and Haas Company.
Robert Runser, Vice President and Controller, The Signal Companies.
Joseph R. Creighton, Vice President and General Counsel, Harris Corporation.
Norman Pacun, Vice President and General Counsel, Ingersoll-Rand Company.
William T. Satterwhite, Senior Vice President, General Counsel and Chief Legal Officer, Enserch Corporation.
Alexander Perry, President, Association of American Chambers of Commerce in Latin America.
Shaw Mudge, President, Shaw Mudge and Company.
Mark Feldman, Donovan, Leisure, Newton & Irvine.

June 16, 1981

Honorable John S. R. Shad, Chairman, Securities and Exchange Commission.
Philip B. Chenok, President, American Institute of Certified Public Accountants.
Roderick M. Hills, Latham, Watkins & Hills.
A. A. Sommer, Jr., Morgan, Lewis & Bockius.

July 23, 1981

Honorable Robert Graham, Governor of Florida, for the National Governors Association.
Theodore C. Sorenson, Paul, Weiss, Rifkin, Wharton & Garrison.
William A. Dobrovir, Dobrovir, Oakes & Gebhardt.
Philip B. Heymann, Harvard Law School.
Harvey L. Pitt, Fried, Frank, Harris, Shriver & Kampelman.
Wallace Timmeny, Kutak, Rock & Huie.
John Burton, Professor of Accounting and Finance, Graduate School of Business, Columbia University.
R. W. Moore, President, Financial Executives Institute.
William E. Thompson, Chairman of the Board, Institute of Internal Auditors, Inc.

July 24, 1981

Harold M. Williams, former Chairman, Securities and Exchange Commission.

PURPOSE OF THE LEGISLATION

The legislation would amend the Foreign Corrupt Practices Act of 1977 (the "FCPA") in order to address a number of significant problems identified with the Act's implementation. In making these changes, the bill expressly adopts the view that the principal goal of the FCPA—outlawing bribery by United States corporations of foreign officials—is a worthwhile goal which should continue to be pursued.

At the same time, however, the bill recognizes that troublesome and often unnecessary problems have arisen under the FCPA, in many instances because of the lack of clarity in the Act and the different interpretations which have arisen concerning its meaning. As a result of these unnecessary interpretive problems, U.S. businesses have lost legitimate export opportunities and have incurred unreasonable costs in attempts to comply with the FCPA's provisions. These problems can be expected to continue until the Act is amended.

HISTORY AND BACKGROUND OF THE LEGISLATION

The FCPA was enacted in 1977 in response to disclosures of questionable and in some cases illegal foreign payments made by U.S. companies to foreign officials in order to secure export business. The Act created both civil and criminal penalties for violation of "anti-bribery" provisions which outlaw payments made to foreign officials to secure business. Because many of the payments disclosed were made by foreign sales representatives of the U.S. companies, the Act included a provision designed to establish the circumstances under which a U.S. concern or its officers would be held responsible for a payment made by a representative.

In order to complement the anti-bribery provision, the Act also included "accounting provisions" applicable to companies which file periodic reports with the Securities and Exchange Commission. These provisions require each issuer to make and keep accurate accounting records and to devise and maintain internal accounting controls providing "reasonable assurances" that specified goals are met. These goals, which were borrowed from authoritative accounting literature, generally involve proper recording of economic events affecting the corporation and adequate safeguarding of its assets in accordance with accepted accounting practices.

The purposes of both the anti-bribery provisions and the accounting provisions were and remain laudable; indeed, the Senate twice passed bills unanimously which adopted these provisions in similar form.

Unfortunately, implementation of these and related provisions of the FCPA has demonstrated that the lack of clarity in the provisions, and the incorporation into the statute of standards which are not realistic in the practical world in which international commerce operates, have created unacceptable and unnecessary burdens on those required to comply with the statute. As a result, the direct and indirect costs of compliance with the FCPA and the lost opportunities of U.S. businesses have been excessive, and there is a compelling need to re-examine and refine the provisions of the Act in order to reduce or eliminate unnecessary compliance costs, without undermining the basic purposes of the FCPA.

NEED FOR THE LEGISLATION

There is widespread bipartisan agreement that the Foriegn Corrupt Practices Act needs substantial revision. This was illustrated by the testimony in support of the bill by the Honorable Robert Graham, Governor of Florida, who testified before the Subcommittees on behalf of the National Governors Association:

> The point I want to emphasize is that this is not a partisan issue and concern did not originate this year or with the administration of President Reagan.
>
> The Governors Association, a bipartisan organization, began studying this issue in 1978 and endorsed a revision of the act in early 1980.
>
> President Carter concluded in his report to Congress on export disincentives that this act " * * * inhibits exporting because of uncertainty within the business community about the meaning and application of some of its key provisions * * * ."
>
> Reubin Askew, my predecessor as Governor of Florida, and U.S. Trade Representative during the Carter administration, stated in an address in June 1980 on priorities in international trade that: "We must clarify the Foreign Corrupt Practices Act to make it enforceable and to eliminate needless uncertainties and anxieties which inhibit trade and complicate trade and investment decisions * * *."
>
> It is clear that there is longstanding bipartisan support for improvement of this act.

Similarly, Theodore C. Sorensen, a strong advocate of the FCPA in 1977, stated before the Subcommittees:

> To refine the 1977 law, however, to make it more certain and less cloudy, to sharpen its focus on corrupt practices by réducing the threat that its broad ambiguities pose to innocent conduct, would be highly desirable. The vague and sweeping language of the present law has to my personal knowledge caused some wholly honorable entrepreneurs to stop doing business abroad and caused others to erect distorted and inefficient business structures as a shield against any unintended liability.

The source of the widespread support for revision of the FCPA stems from the unforeseen chilling effect that it has had on U.S. exporters seeking, in good faith, to comply with its provisions. The FCPA was an unprecendented piece of legislation, with its principal focus intended to extend U.S. criminal law beyond our borders. As Deputy Attorney General Schmults testified, the need for clarity in these circumstances is particularly great. Experience with this extraterritorial statute during its four-year history has demonstrated the need for refinement. With regard to the antibribery provisions, that need has centered on such questions as appropriate provisions for third party liability and the definition of the types of facilitating payments and other expenses which should not be prohibited under the provisions of the legislation.

Referring to the "reason to know" test embodied in the FCPA the nexus for liability for actions of third parties, Mr. Sorensen sta the following:

> I recognize Congress desired in 1977 to prevent the widespread circumvention of this act by thirdparty payments to which the domestic concern deliberately turns a blind eye. But no other provision of the act has caused more confusion and deterred more export activity on the part of many an American businessman who had no intention to pay bribes but a great fear of finding himself unintentionally liable for the unauthorized, unforeseeable, and unknown acts of his company's independent agents whose misdeeds, some prosecutor might someday allege, that businessman had "reason to know."
>
> This phrase is a difficult, ambiguous test based even in legal literature on inferences, assumptions, unconscious knowledge and probabilities—not a fair standard, surely, in such a murkey, uncharted area of the law as this, which can impose criminal liability.

Ambiguities involved in this provision have caused some leg commentators and cautious legal counsel to equate "reason to kno with "reason to suspect."

Two examples of the effect of the "reason to know" provision we given to the Committee by Harris Corporation General Couns Joseph Creighton:

> The problem with the "reason to know" concept is illustrated by a specific experience in a foreign nation. In connection with a potential contract in a third world nation, where a company was represented by a sales representative having over twenty-five years of experience in that nation, a representative of the American company called upon the United States Embassy to determine if our Embassy could be of assistance in any way. The United States official there gratuitously commented that payoffs were customary in the nation involved and that sometimes one agency of the government was required to make payments to another agency of the same government in order to get any govermental business transacted. Upon receipt of this statement, did the American company representative have reason to believe that any contract which the company later received could involve some improper payment from someone to someone else? For the particular company described above, the problem dissolved when the contract was awarded to a competitor. However, the situation is illustrative of a very common problem which exists throughout much of the world.
>
> Well, another lawyer told me of a situation—he did not give me the name; I trust him, however—he outlined a situation where he was dealing with about a $6 to $8 million contract in a less-developed country. And he got—the company's comptroller got, a call from a marketing person who said that, at a dinner, somebody had told him that there had been some payment made.

The whole sales effort stopped, and about 2 weeks went by. Ultimately, this lawyer's legal advice was, "Well, you don't dare proceed without conducting an investigation." Now, there is one three-time-hearsay statement made. This required an investigation. Now, this is a case where the business was not lost, and they concluded that there was no basis—the individual who was charged with this denied that there was any impropriety. But there was great risk of loss during that time.

And I would have to say, who knows whether the statement received was true or false, on either side? It is a very difficult thing for a company to deal with.

The problem becomes particularly acute for small businesses, who must do virtually all of their overseas business by means of foreign agents, over whom they may have very little or no control.

The other area of primary concern, that of facilitating payments, has also been a source of major problems. The intention of the drafters of the FCPA was that facilitating, or "grease," payments designed to expedite, for example, the unloading of ships in ports as well as the appropriate giving of gifts, tokens of esteem, courtesies, demonstration items, etc., not be prohibited by the anti-bribery provisions. Nevertheless, the wording of the FCPA (which refers to the duties of the recipient of a payment) has proved unworkable and has failed to convince American businessmen that these kinds of activities can be conducted without the serious threat of both civil and criminal liability. The consequence has been the unnecessary handicapping of American business by a continued deprivation of what are often necessary marketing tools available to their competitors.

Ambassador Brock furnished for the Committee a list of examples of lost trade and increased costs caused by the problems in the FCPA:

EXAMPLES OF LOST TRADE AND INCREASED COSTS CREATED BY THE FCPA

Disincentives Created by the FCPA's "Reason To Know" Clause:

(1) The U.S. Embassy in Muscat, Oman, reported that a U.S. firm lost a $20–$30 million contract solely because of the time delays needed to investigate sales agents and assess their responsibility for third parties under the FCPA.

(2) A multinational U.S.-based engineering company spent approximately $250,000 to evaluate its potential market in Latin America, Brazil, Mexico, and Venezuela were considered open markets for exporting engineering services and establishing local service branches. One of the major reasons the company chose not to expand was its uncertain liability under the FCPA for the activities of independent agents and subcontractors. Moreover, the cost of policing such activities would have markedly lessened its price competitiveness.

(3) In Oman, a large Utah firm has encountered difficulty over the past couple of years in its efforts to obtain

a local representative. After many discussions, the U.S. company narrowed the field to one Omani firm which it felt would best represent its interests, but the Americans have been unable to reach an agreement due to potential problems arising under the FCPA. Since the firm's business runs in multimillion dollar contracts involving proprietary technology, lost U.S. exports may have been substantial.

(4) In Liberia, U.S. firms will not risk hiring local agents because of potential liability under the FCPA for their unsanctioned actions. Instead, they have come to rely on more expensive expatriates with fewer ties to local business people. Not only has the cost of doing business in Liberia gone up, U.S. firms have lost their competitive edge.

(5) The U.S. embassy in the United Arab Emirates reports that overlap between business and government has been a problem for U.S. firms seeking to do business there. At best, the overlap has made it more difficult for U.S. firms to begin operations—in many cases months pass while home office legal staffs review potential sponsorship agreements. Some firms have signed relatively ineffective agents rather than violating the FCPA, or at worst, have decided not to enter the market at all. At the same time, the U.S. image in the host country suffers, because many reputable businessmen resent what they perceive as a questioning of their own honesty in business dealings.

(6) In Qatar, only one of the state's 14 cabinet ministers has no known business ties, and U.S. firms often fear that business payments may be construed as illicit payments to foreign officials. American firms there generally avoid agents in government positions, but they are then restricted to less effective agents with fewer business connections throughout the region.

Increased Costs and Lost Trade Generated By Confusion Over What Constitutes a Facilitating Payment:

(1) The local director of an American company in a foreign country paid a customs official $20 to process the release forms for spare parts to a broken machine; the official suggested that the alternative would have been to wait several days for "further formalities." According to the FCPA's legislative history this should have been a legal payment, and the local director was reimbursed by his managing director in the U.S. Because of uncertainty over what constitutes a facilitating payment, however, the payment did not pass the internal auditor from the home office. The American managing director's career is now on the line, and the parent company has spent $30,000 internally investigating why the $20 payment was made and how to cope with it under the FCPA.

(2) During a trip to Singapore, a U.S. company learned that a series of payments would be required in order to do business in Indonesia. These included payments to the switchboard operator in the hotel, to secretaries for arranging appointments, to the administrative assistant of the customer to meet with the customer, to all company sales representatives, to guards watching unloaded merchandise, and to customs officials. Unclear as to which payments were prohibited by the FCPA, the company did not compete to install communications equipment.

(3) Since Brussels, Belgium is the headquarters for many companies which do business in Africa and the Middle East, the U.S. embassy there detected that American firms avoid export opportunities which corporations from other countries do not hesitate to undertake. A U.S. construction firm, for example, was interested in bidding on a project in a Middle Eastern country where facilitating payments are both customary and necessary. Unwilling to confront the FCPA's ambiguous definition of facilitating payments, the firm decided to be a subcontractor for a European prime contractor and accept a much smaller portion of the project.

Consequences of Failure to Follow Customary Business Practices in Foreign Markets:

(1) In China, a U.S. firm had concluded a $4 million contract for the supply of construction equipment. The American firm, overzealous about enforcing the FCPA, then refused to pay legitimate commissions to a Chinese distributor because of technical delays in obtaining receipts from the Bank of China. The Chinese distributor revoked the contract and purchased the construction equipment from a Japanese firm that was willing to pay the commission.

(2) In Thailand, it is normal practice to "assist" government officials through cash payments, gifts, free travel, etc. A U.S. office equipment company, concerned about potential FCPA violations, refused to "assist" potential customers. In one case of lost business, the U.S. firm obtained the bid documents. Had the company made the requested payments, its bid would still have been 15 to 10 percent lower than the Japanese firm which won the contract.

(3) A U.S. company had been considering setting up wholly-owned marketing companies in countries such as the Phillipines, Indonesia, Thailand, South Korea, and Taiwan to replace local sales agents. In light of local customary business practices, these plans were deferred indefinitely because of excessive expenses for ensuring compliance with the FCPA.

Negative Foreign Response to the FCPA:

(1) A large American firm was pursuing a joint venture agreement with a reputable Saudi firm. In order to protect itself from the unknowns of the FCPA, the U.S. firm insisted on protective language in the contract. The Saudi firm was offended by inferences that its officers were corrupt and delayed the negotiating process. Meanwhile, a third country firm received a lucrative contract from the Saudi Arabian government which had been tentatively awarded to the partners-to-be. The joint venture may never be worked out because of the bad feelings which were generated in the contract negotiations and due to the loss of the contract.

(2) In another case, one American and one Saudi firm were engaged in negotiations concerning an industrial joint venture involving more than $100 million in capital. Because of the large amount of money involved, the American company insisted on a buy-out clause which it tied to the FCPA. The Saudis, however, could not accept the provision because they felt that the FCPA was vague and feared that the U.S. firm could pull out and demand compensation at any time by claiming that the law had been broken. Although negotiations continued for several months, the joint venture never materialized.

(3) An American steel company which was negotiating a cooperative venture with a Chinese corporation refused to pay for travel expenses in the U.S. during a planned trip by the Chinese executives to inspect the American company's facilities. Offended by the American company's refusal to pay under the FCPA, the Chinese executives never visited the U.S. and cut off contract negotiations.

(4) An American company held 20 percent equity in a company in Southeast Asia. Under a consent agreement reached with the U.S. government, the manager of the American company was required to sign quarterly statements of FCPA compliance. The board of the foreign company requested that the U.S. firm either replace the American manager with another national who would not be required to sign the compliance statement or divest their interest in the company. Since a change of manager would not release the American company from the FCPA compliance agreement, they were forced to divest. The losses for 1979 on the investment, management fees, and profit sharing were estimated at $2 million.

(5) A European consortium received a foreign contract for an amount 333 percent greater than the U.S. company's preliminary bid. The U.S. company believes the prospective customer did not want to deal with a company subject to the FCPA.

Lost Business Arising From U.S. Firms Withdrawing From Existing Markets:

(1) A U.S. firm in Cameroon withdraw its bid for a $15 million television contract when several European

firms entered the competition. The firm simply did not want to compete for the contract because it felt the FCPA might become an issue.

(2) In Haiti, no U.S. firm has competed for any of the major projects undertaken in the last 18 months. These included: a sugar mill worth $45 million, a vegetable oil refinery costing $12.5 million, a new fishing fleet priced at $16.6 million, and a contract for a new bus fleet worth $2 million. The U.S. embassy there speculated that the FCPA was the major disincentive to competition.

In a January, 1981 policy statement of the Securities and Exchange Commission dealing with the accounting provisions, former S.E.C. Chairman Harold Williams stated, "The anxieties created by the act among men and women of utmost good faith, have been, and in my experience, without equal." Referring to U.S. businessmen, U.S. Trade Representative William Brock asked the question, "Why are they anxious? Because they don't know where they stand, and that's incredible under U.S. law."

In a submission to the two subcommittees, the Section of Corporation, Banking and Business Law of the American Bar Association noted:

> Now, more than three years following the enactment of the FCPA, many important questions remain unanswered under the anti-bribery and accounting provisions. The confusion has continued to grow. It is time to correct these deficiencies without impairing the basic thrust of the legislation—that it shall be unlawful for U.S. corporations to bribe foreign government officials in order to obtain or retain business.

The problems of interpretation under the FCPA have been compounded by the difficulty which businesses have encountered in obtaining guidance about the scope and meaning of the Act. The division of enforcement jurisdiction over the anti-bribery provisions has contributed to this problem, because of concern that the Department of Justice and the SEC might adopt conflicting interpretations of the same provisions of the law.

The bill approved by the Committee responds to the problems created by the FCPA without diminishing its underlying goals. Among the principal features of S. 708 are the following:

1. Amendment of the provision which holds a U.S. concern liable for an illegal payment by an agent, based upon the ambiguous and controversial "reason to know" standard. The bill would replace this standard with one specifying liability where a corrupt payment is made and the U.S. concern directs or authorizes, expressly or by a course of conduct, that the payment be made.

2. Revised formulation of the FCPA's accounting provisions, so that (a) a single provision requiring internal accounting controls, rather than two separate accounting provisions, sets forth the accounting requirement of the Act; (b) the addition of a definition of the term "reasonable assurances" in the internal accounting controls requirements, in order to make clear that corporate managers, having

in mind costs and benefits, have considerable latitude in making decisions about changes in internal accounting controls; and (c) inclusion in the accounting provisions of an explicit *scienter* standard in order to make clear that only knowing failure to comply with the accounting requirements can be the basis of liability.

3. Clarification of the extent of responsibility of a U.S. company for the accounting standards of a partially-owned subsidiary.

4. Consolidation of enforcement of the anti-bribery provisions in the Department of Justice, in place of the present split jurisdiction in which the Justice Department is responsible for criminal enforcement, and the Justice Department and the SEC have split authority with respect to civil violations.

5. Enhanced authority for the Justice Department to conduct civil investigations and to subpena information for such investigations.

6. Revision and clarification that certain types of payments, such as "facilitating" payments, payments lawful in the country where made, and certain other types of payments are not prohibited by the statute.

7. Emphasis on the Business Practices and Records Act as the principal statute under which enforcement actions relating to foreign payments are to be prosecuted.

8. Statutory sanction of guidelines, to be issued by the Attorney General, in consultation with other interested federal officials, providing guidance to business concerning compliance with the anti-bribery provisions of the Act, as well as the establishment of a review procedure in order to provide guidance with respect to specific inquiries about enforcement intentions under the Act.

9. Statutory emphasis on the need for multilateral responses to the problems caused by foreign corrupt practices, so as to remove the current disadvantages to United States exporters caused by the Act.

NATURE AND SCOPE OF THE BILL

1. Amendments to the Accounting Provisions

The accounting provisions of the Foreign Corrupt Practices Act, contained in Section 13(b)(2) of the Securities Exchange Act of 1934, were enacted as a complement to the anti-bribery provisions, and were designed to establish minimum record-keeping and internal accounting controls standards for issuers registered with or reporting to the Securities and Exchange Commission.

The provisions, however, are not expressly tied to the anti-bribery sections of the FCPA, and their reach extends to transactions and to issuers which are not involved, directly or indirectly, in exports.

The existing accounting provisions require each issuer subject to the requirements to—

> (A) make and keep books, records, and accounts, which in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer; and
>
> (B) devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that—
>
> > (i) transactions are executed in accordance with management's general or specific authorization;

(ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets;

(iii) access to assets is permitted only in accordance with management's general or specific authorization; and

(iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

As now constituted, these provisions have proven to be overly burdensome requirements which have caused businesses to incur costs substantially in excess of the benefits derived from these expenditures.

This has occurred for several reasons:

1. As enacted in 1977, the accounting provisions consist of two separate requirements: first, each issuer is required to maintain specified types of books and records: secondly, internal accounting controls must be maintained which meet the tests ennumerated in subparagraph (B).

Since 1977, there has existed considerable uncertainty about the standards required by the two parts of the provisions, and the relationship between them. In particular, concerns have been expressed that the recordkeeping provision demands a degree of precision in accounting records which is unattainable in practice.

In this regard, it is widely acknowledged that *no* system of internal accounting controls, no matter how extensive, can prevent all errors or inaccuracies in a company's records. For example, Philip Chenok, President of the American Institute of Certified Public Accountants, explained in the hearings that "no system of internal accounting control can prevent, *or could be devised to prevent* someone from overriding that system . . . You cannot prevent individuals from doing certain things simply by the design of an accounting system."

Under these circumstances, the Committee believes that the appropriate focus of the accounting provisions should be upon the internal accounting controls system maintained by an issuer rather than upon whether particular inaccuracies exist. The existence of a separate recordkeeping provision has created significant problems of interpretation and has led to justifiable concern that small errors which do not undermine the internal accounting controls system, or false or inaccurate records that are detected in the ordinary course of a company's operations, would be considered violations of the statute. This danger exists under present law regardless of whether the records involved have any relationship to foreign operations and apply to companies which have no foreign sales.

There are a number of circumstances apart from the recordkeeping requirements of the FCPA which provide assurances that corporate records will be accurate, and these factors will continue to foster accurate recordkeeping. In light of these circumstances, the benefits of having a separate federal recordkeeping requirement are not sufficient to outweigh the interpretive problems that such a provision has created and the unnecessary expenses which have resulted.

The most important factor encouraging accuracy in recordkeeping is the fact that accurate records are necessary for corporate managers to effectively conduct the business of a company. Thus, the accounting provisions in a sense merely require business ventures funded by the investing public to install recordkeeping and control procedures which would appear necessary as a matter of effective management. However, there are inherent difficulties in codifying good business practices into federal law, including the interpretive problems described above.

Aside from the requirements of effective management, accurate records are generally necessary in order to permit issuers to prepare financial statements and to comply with the disclosure requirements of federal securities laws. It is implicit in the requirement that issuers must file materially accurate financial statements that they will be based on books and records which permit them to do so. Serious recordkeeping deficiencies would give rise to violations of the disclosure provisions.

A third factor that encourages issuers to maintain accurate books and records, irrespective of a federal statutory recordkeeping requirement, is the fact that issuer's financial statements must be audited annually. If the auditor discovers sufficiently serious deficiencies in recordkeeping which go uncorrected, he will either give a qualified opinion concerning the financial statements or render no opinion at all.

Another factor encouraging the integrity of corporate recordkeeping is the existence and function of the internal accounting controls provisions. These provide, among other things, that such controls must provide "reasonable assurances" that a company's records will reflect transactions as necessary to permit the preparation of financial statments in conformity with generally accepted accounting principles, and to maintain accountability for assets. It is in the very nature of a system of interal accounting controls that it should uncover recordkeeping inaccuracies from time to time. Once such matters are brought to light, it is the responsibility of management officials to take such corrective action as may be appropriate in light of the "reasonable assurances" standard in the bill. Accordingly, the internal controls provision makes the failure to take corrective action a violation of law, if the deficiency is so serious that the system of internal accounting controls does not provide the required "reasonable assurances."

Finally, the bill's revision of Section 13(b)(2) would add accurate recordkeeping, in reasonable detail, to the list of statutory objectives of an internal controls system. The addition of accurate recordkeeping as an explicit purpose of the required internal accounting controls is intended to clarify that the deletion of the separate recordkeeping section does not reflect a lessening of the importance of accurate recordkeeping to the attainment of the goals of the accounting provision of the Act.

The use of the word "accurate" has caused some concern that the Act requires a degree of perfection which is neither familiar in accounting literature nor attainable in practice. In this regard, the

Committee repeats its explanation of the term in the 1977 report accompanying the bill which became the FCPA:

> . . . the term "accurately" does not mean exact precision as measured by some abstract principle. Rather it means that an issuer's records should reflect transactions in conformity with generally accepted accounting principles or other applicable criteria.

2. The accounting provisions of the FCPA are not explicitly limited to "knowing" violations. Although enactment of the FCPA was based upon the widespread disclosures of intentional acts relating to illegal or questionable payments of U.S. corporate funds to foreign officials, the accounting provisions contain no clear standard for limiting responsibility to intentional actions. The absence of any such standard has led to substantial uncertainty, with some commentators suggesting that inadvertent or innocent errors in a company's books could be the basis of liability. As a result, issuers subject to the accounting provisions have in many cases incurred excessive compliance costs because of a desire to comply with the law and a concern that the Act might ultimately be determined to impose a unduly strict standard of liability.

The Committee believes that the purpose of the FCPA accounting provisions was to proscribe knowing conduct, not unknowing conduct. Accordingly, the bill provides that violations only occur where a person "knowingly" violates Section 13(b)(2). In adopting this standard, the Committee intends to assure that the accounting provision, as modified, is the basis for enforcement action only in cases where a conscious awareness of wrongdoing is present, and not in situations in which mere negligence or other conduct not reflecting such an awareness results in some imperfection in a company's internal accounting control system or an unintentional circumvention of that system.

Section 32 of the Securities Exchange Act of 1934 provides the general basis for criminal liability for violation of any provision of the Act. It is not intended that the use of the term "knowingly" in new section 13(b)(4) of the Act affect the general requirement that criminal violations of the 1934 Act be "willful". Instead, the "knowing" standard adopted by the Committee is intended to apply to civil enforcement actions under the revised Act.

The Committee combined in a single provision the requirements of adequate books and records and of internal accounting controls which provide "reasonable assurances" that the specified statutory objectives are met. By explicitly including within the goals of the internal accounting controls requirement the principle formerly embodied in the separate recordkeeping requirement, the Committee's action reflects that (1) the adequacy of the internal accounting controls system is the appropriate measure of compliance with the statute; and (2) the system must be devised and maintained in a manner which provides reasonable assurances of, among other things, accurate and fair books and records. However, the elimination of a separate recordkeeping provision precludes the possibility of an enforcement action based solely on the fact that records are inaccurate.

Instead, under the revised Section 13(b)(2) and the *scienter* standard adopted by the Committee, an issuer would only be subject to an enforcement proceeding where it knowingly fails to maintain, or knowingly circumvents or attempts to circumvent for an improper purpose, an internal control system in a manner so that the system fails to provide the required "reasonable assurances" as defined in the bill.

Individuals who knowingly perpetrate the falsification of accounting records or knowingly fail to record transactions (for some improper purpose) could also be liable under principles of secondary liability (for example, under principles of aiding and abetting), if their actions establish that the issuer's internal control system does not provide the necessary "reasonable assurances".

3. The internal accounting control provision in the current law does not contain any explicit reference to the consideration of the costs and benefits of internal accounting controls, even though there is widespread agreement that particular controls or changes in systems of controls should only be required where they produce meaningful benefits in excess of the costs to be incurred. Similarly, the Act does not expressly provide that those responsible for internal accounting controls systems are to be given latitude in making judgments about the appropriateness of controls in particular cases.

The language of the accounting provisions in the Act was borrowed from authoritative accounting literature and, the Committee believes, was premised upon widely accepted auditing and accounting practices. In that connection, this Committee's Report accompanying the bill which became the FCPA indicated that "management must necessarily estimate and evaluate the cost/benefit relationships of the steps to be taken in fulfillment of its responsibilities" under the accounting provisions. However, doubts have continued to exist about the degree of latitude which issuers have in fashioning internal accounting control systems meeting the statutory objectives as well as about the consequences of an honest error in judgment in connection with a decision about internal controls.

The hearings preceding the Committee's consideration of S. 708 reflected widespread agreement that cost/benefit criteria should be incorporated into the statute, although different formulations of such a standard were suggested. The bill would incorporate by definition of the term "reasonable assurances" the concept that the design and internal accounting controls are the responsibility of the issuer's management having in mind the likely costs and benefits, and, accordingly, their decisions should be accorded discretion.

The use of a cost/benefit test is clearly appropriate with respect to the definition of "reasonable assurances". In fact, Statement on Auditing Standards No. 1, from which the existing accounting provisions were derived, defines "reasonable assurance" as follows:

> The definition of accounting control comprehends reasonable, but not absolute, assurance that the objectives expressed in it will be accomplished by the system. The concept of reasonable assurance recognizes that the cost of internal control should not exceed the benefits expected to be derived. The benefits consist of rèductions in the risk of failing to achieve the objectives implicit in the definition of accounting control.

The auditing standard adds that:

> Although the cost/benefit relationship is the primary conceptual criterion that should be considered in designing a system of accounting control, precise measurement of costs and benefits usually is not possible; accordingly, any evaluation of the cost/benefit relationship requires estimates and judgments by management.[1]

The reference to cost/benefit analysis in the bill is not intended to suggest or require that a company establish elaborate methodologies in order to measure the implications of changes in internal accounting controls.

Records of subsidiaries

The FCPA accounting provisions have created an additional problem with respect to the legal responsibility of an issuer for compliance by subsidiaries with the accounting requirements. The language of the FCPA is silent on this issue, and conflicting views have been expressed concerning the nature of this responsibility, particularly with respect to subsidiaries in which an issuer owns a minority interest.

S. 708 provides that such an issuer's responsibility is discharged where the issuer makes a good faith effort to cause the subsidiary to comply with the amended requirements of Section 13(b)(2). This approach is based upon the recognition that it is not realistic to expect a minority owner to exert a disproportionate influence over the accounting practices of a subsidiary's internal accounting controls. The amount of influence which an issuer may exercise necessarily varies from case to case, depending on a variety of factors. While the relative degree of ownership is obviously one factor bearing on the issuer's influence, other factors may also be important.

The good faith requirement approved by the Committee is intended to be consistent with the other amendments to the FCPA incorporated in S. 708, in that the issuer's conduct, rather than that of persons or entities not subject to the issuer's control, will determine whether or not the issuer is deemed to have violated the internal accounting controls provision.

AMENDMENTS TO THE ANTIBRIBERY PROVISIONS

Section 5(a) places in the Justice Department all jurisdiction for enforcement of the anti-bribery provisions of the Act. The SEC remains responsible for civil enforcement of the internal accounting controls provisions and relevant securities laws. Under current law the SEC has authority for enforcing against "issuers" the civil remedies for violation of the anti-bribery provisions. The Justice Department enforces against "issuers" the criminal remedies for violation of the anti-bribery provisions and the civil and criminal remedies for such violation against "domestic concerns."

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[1] American Institute of Certified Public Accountants, codification of *Statements of Auditing Standards*, Section 320.32.

The Committee bill continues the prohibition against foreign bribery, but it is intended to clarify the ambiguities which have caused confusion and lost sales among U.S. exporters attempting to comply with the FCPA.

Section 104 of the FCPA would be repealed and replaced by language which conforms to domestic bribery statutes. The jurisdictional predicate of the FCPA, however, has been retained, and domestic concerns are prohibited from making use of the mails or any other instrumentality of interstate commerce to make payments for the purposes of influencing any act or decision of a foreign official in his official capacity, or inducing him to do or fail to do any act in violation of his legal duty as a foreign official. Such payments are also prohibited for inducing a foreign official to use his influence to assist a domestic concern in obtaining or retaining business, or to direct business to any person.

Because of the breadth and lack of clarity concerning the "reason to know" standard (see discussion in "Need for the Legislation"), the Committee decided to substitute a new, more precise standard. As introduced, S. 708 would have substituted for the present law a provision that a domestic concern's liability for a payment would be limited to situations in which the domestic concern "corruptly directs or authorizes" the payment. The purpose of this standard was to assure that the conduct of the domestic concern, rather than of other parties, would determine the scope of liability of the domestic concern.

While the standard proposed in S. 708 received widespread support from witnesses representing the business community, it was criticized by some witnesses as being too strict a standard. Specifically, it was argued by some witnesses that the standard in S. 708 might permit businesses to encourage their agents to make corrupt payments without expressly "directing" or "authorizing" the payment.

The Committee adopted an amendment to S. 708 in order to address this concern. The new Section 104(b) would make it unlawful for any domestic concern corruptly to "direct or authorize, expressly or by a course of conduct," a third party to bribe a foreign official.

The Committee intends the term "course of conduct" used with the term "authorize" in Section 104(b) to refer to those situations where a company, through its words or course of conduct, has intended that a corrupt payment be made. For example, a company's refusal or failure to respond to an agent's suggestion or request that a corrupt payment be made would violate this section, as would a company's continuing employment of an agent known to the company to have made corrupt payments in the preceding two years in violation of applicable U.S. laws or those of the country in question.

On the other hand, the mere fact of doing business in a country where corrupt payments are common, or the employment of an agent with personal relationships with government officials in the country where the company seeks to do business would not establish such a course of conduct. Similarly, the payment of a commission that is higher than customary would not by itself violate this section without evidence that the increased amount of commission is intended to permit a corrupt payment to be made.

The Committee believes that this standard will result in liability being imposed in overseas bribery cases brought under this Act if liability would also be imposed if the case were subject to domestic bribery law.

Likewise, the new Section 104(c) is intended to eliminate the ambiguities of the current law concerning facilitating or so-called "grease" payments. The FCPA contains an exemption for such payments, by excluding from the definition of the term "foreign official" an employee "whose duties are essentially ministerial or clerical". Unfortunately, that definition has proved arbitrary and difficult to apply in practice, in part due to the multitude of relationships and responsibilities of employees of foreign countries.

The Committee bill presents a different approach to facilitating and other payments not intended to be covered by the Act, than that embodied in current law. While the FCPA seeks to define facilitating payments in terms of *recipients*, the Committee bill would remove uncertainty about the facilitating payments exception by defining such payments in terms of their *purpose*. It provides for the following exceptions:

> Facilitating or expediting payments to a foreign official, the purpose of which is to expedite or secure the performance of a routine government action as opposed to one involving judgment as a significant factor;
>
> Items lawful under the laws of the foreign official's country;
>
> Items which constitute a courtesy, or a token of regard, or esteem, or in return for hospitality;
>
> Expenditures associated with the selling or purchase of goods or services or with the demonstration or explanation of products;
>
> Ordinary or customary expenditures associated with the performance of a contract.

The Committee wishes to emphasize that the exception for facilitating and expediting payments should not be interpreted to undermine the basic anti-bribery purpose of the statute. To make this point clear, the provision distinguishes the exception from situations involving government action in which the exercise of a foreign official's judgment is a significant factor. The Committee intends for judgment in this context to refer to the decisions by a foreign official relating to the question of whether, or on what terms, to award new business to or to continue business with a particular party.

The Committee believes this greater precision is needed in defining exceptions to the Act, given the widely differing interpretations of legitimate facilitating or "grease" payments over the past four years and the divergent situations which arise in foreign countries.

The Committee also specifically excludes from the bill's definition of bribery those payments which are "lawful under the laws and regulations of the foreign official's country." In doing so, the Committee was mindful of the delicate balance discussed by Ernest Johnston, Deputy Assistant Secretary of State for Economic and Business Affairs, when he testified:

> The problem is one of balancing two competing interests: restricting potentially harmful business practices overseas by U.S. firms, while refraining from imposing our own standards

> on others. I think the approach in S. 708 [which is similar in the Committee bill] achieves such a balance by excluding actions which are legal in a specific country and by permitting customary payments to facilitate or expedite transactions. It will go far to meet the genuine concerns of our business people, while reducing our own judgments on standards other countries choose to set for themselves.

The bill also addresses the potential problem that conduct which would be lawful under the Business Practices and Records Act could nevertheless be prosecuted under the mail or wire fraud statutes, with prosecution based on the theory that those statutes could be used to allege that a foreign official violates a fiduciary duty to his country. The bill would preclude prosecutions based upon that theory.

The Committee recognizes the continuing need for international agreements outlawing bribery in the international marketplace. The unilateral position currently taken by the United States in terms of anti-bribery legislation, while laudable, constitutes a serious disadvantage to U.S. commerce. The Committee recognizes that bribery warps appropriate trade patterns and distorts the market as an efficient allocator of resources, but it believes that the most useful approach to this problem is a multilateral one.

The Committee bill would enhance U.S. efforts to achieve such international agreement by presenting a statute that effectively curbs bribery without imposing unnecessary trade disincentives. Recognizing this need, the bill calls for renewed efforts, both on multilateral and bilateral levels, to achieve international agreement on the prohibition of bribery.

SECTION-BY-SECTION ANALYSIS OF THE BILL

Short title

Section 1 provides that the legislation may be cited as the "Business Accounting and Foreign Trade Simplification Act."

Findings and conclusions

Section 2 contains five Congressional findings, noting the positive contribution of the Foreign Corrupt Practices Act, the unnecessary concern, cost, and burden posed by some of its provisions, and the interest of all countries in maintaining responsible standards of corporate conduct in foreign markets. Congress reaches four conclusions: that the principal objectives of the FCPA are important to the nation, that exporters should not be exposed to conflicting demands from diverse enforcement agencies, that compliance practices should be considered in balance with other national objectives and that the U.S. should seek appropriate international cooperation to solve the problem of corrupt payments.

Amendment of short title

Would change the short title of the Foreign Corrupt Practices Act of 1977 to the "Business Practices and Records Act", reflecting the fact that certain provisions of the Act apply to entities irrespective of foreign activities and removing the implication of wrongdoing embodied in the former title.

Accounting standards

Section 4(a) would revise the existing accounting provisions of the law by (1) eliminating the separate provision requiring accurate books and records, and (2) incorporating the principle of the recordkeeping into the statutory objectives of the remaining internal accounting control requirement.

As modified, the provision would require each issuer subject to the reporting requirements of the Securities Exchange Act of 1934 to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that five specific goals are met.

Section 4(b) would add a new paragraph (4) to Section 13(b) of the Securities Exchange Act to establish a *scienter* standard for any violation of the accounting provisions.

In addition, a new paragraph (5) would also be added, which defines the responsibility of an issuer with respect to the accounting practices of a domestic or foreign subsidiary in which the issuer owns an interest of 50 percent or less.

Transfer of jurisdiction

Section 5(a) would place in the Justice Department all jurisdiction for enforcement of the anti-bribery provisions of the Act. The SEC would remain responsible for civil enforcement of the internal accounting controls provision. Under current law the SEC has authority for enforcing against "issuers" the civil remedies for violation of the anti-bribery provisions. The Justice Department enforces against "issuers" the criminal remedies for violation of the anti-bribery provisions and the civil and criminal remedies for such violation against "domestic concerns."

Bribery prohibition

Section 5(b) would rewrite section 104 of current law. Subsection (a), designed *inter alia* to bring the Act into conformity with the domestic bribery statutes, would prohibit a domestic concern from making use of the mails or any other instrumentality of interstate commerce to make payments for the purposes of influencing any act or decision of a foreign official in his official capacity, or inducing him to do or omit to do any act in violation of his legal duty as a foreign official, or inducing him to so use his influence, for the purposes of assisting the domestic concern in obtaining or retaining business, or of directing business to any person.

Intermediaries

Subsection (b) of the section 104 rewrite would prohibit bribery through use of intermediaries. It replaces the "reason to know" standard of current law. In its place it makes it illegal for a domestic concern "corruptly to direct or authorize, expressly or by a course of conduct", bribery by means of a third party. Subsection (b) is intended to be the exclusive means of enforcement of the Act with respect to payments made by an agent of a "domestic concern"

Facilitating payments

Subsection (c) of the section 104 rewrite would exempt certain specified facilitating and other payments from the anti-bribery provisions. Such payments include items lawful in the country of the official, courtesies, tokens of esteem, hospitality, travel and lodging expenses, and expenses associated with the demonstration or explanation of products and customary expenditures associated with the performance of a contract.

Penalties

Subsection (d) of the section 104 rewrite would continue the civil and criminal penalties provided for in current law: $1,000,000 maximum fine for domestic concerns; for individuals a maximum fine of $10,000 and/or up to five years imprisonment.

Authority for civil injunction and investigation

Subsection (e) of the section 104 rewrite would consolodate authority to obtain injunctive relief for violation of the Act in the Department of Justice, whereas current law divides the authority between the Justice Department and the SEC. The subsection adds a provision not found in the current law authorizing the Justice Department to conduct civil investigations, and provides subpena authority for such investigations, and provides to the Attorney General rulemaking authority to implement the civil investigation provision.

"Domestic concern" and "foreign official"

Subsection (f) of the section 104 rewrite would define "domestic concern" so as to include citizens, nationals, and residents of the U.S., and companies, business entities, etc. This definition corresponds to the combination of enforcement jurisdiction under the Justice Department.

"Foreign official" would be defined so as to include officers and employees of foreign governments and agencies, political parties, party officials, and candidates.

Definitions

Section 6 defines "reasonable detail" and "reasonable assurances" in terms of "prudent individual" and cost/benefit tests.

Exclusivity provision

Section 7 provides that this Act would preclude the possibility of criminal prosecution against any person or firm alleging that the mail or wire fraud laws have been violated as a result of a foreign corrupt payment, where the prosecution is based upon the theory that the foreign official violated a fiduciary duty.

Similarly, no prosecution for conspiracy to violate the mail or wire fraud statute based on that theory would be permissible.

Authority to issue guidelines

Section 8 would authorize the Attorney General, after consultation with the U.S. Trade Representative, the Secretary of State, the Secretary of Commerce, the Secretary of the Treasury, and representatives of the business community and the public, to issue guidelines to assist in compliance with the anti-bribery provisions. Procedures would be established for firms to request interpretative guidance from the Justice Department, with responses required to be made within thirty days. Provision would be made for the preservation of confidentiality of materials submitted for the purposes of such requests or in connection with investigations.

Annual reports

Section 8 would also call upon the Attorney General and the Chairman of the SEC to submit detailed annual public reports of their respective agency's actions taken pursuant to the Act, its views on associated problems, plans for the next fiscal year, and recommendations, if any, for amendment of the Act.

Conforming changes in Internal Revenue Code

Section 9 would conform the Internal Revenue Code to the restrictions and limitations of the Business Practices and Records Act. As a result, a transaction would be treated under the tax laws as an ordinary business expense if it is lawful under this Act.

International agreements

Declares it is the Sense of the Congress that the President pursue negotiations to establish international cooperation in the prohibition of bribery. Provides for reports to the Congress on the progress of such negotiation, including suggestions for appropriate congressional action, and the consequences of potential action that can be taken under existing law to affect international cooperation for the elimination of bribery.

FISCAL IMPACT STATEMENT

No provision in S. 708 is intended by the Committee to authorize new budget authority.

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, D.C., October 5, 1981.

Hon. JAKE GARN,
Chairman, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Dirksen Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: Pursuant to Section 403 of the Congressional Budget Act of 1974, the Congressional Budget Office has prepared the attached cost estimate for S. 708, the Business Accounting and Foreign Trade Simplification Act.

Should the Committee so desire, we would be pleased to provide further details on this estimate.

Sincerely,

RAYMOND C. SCHEPPACH
(For Alice M. Rivlin, Director).

CONGRESSIONAL BUDGET OFFICE—COST ESTIMATE

OCTOBER 5, 1981.

1. Bill number: S. 708.
2. Bill title: Business Accounting and Foreign Trade Simplification Act.
3. Bill status: As ordered reported by the Senate Committee on Banking, Housing and Urban Affairs, September 16, 1981.
4. Bill purpose: S. 708 would amend the Foreign Corrupt Practices Act of 1977 by revising its compliance and enforcement procedures.
5. Cost estimate: While no appropriation of funds is authorized by S. 708, nonetheless certain costs would be incurred by federal agencies in order to implement this bill.

Estimated authorization level:	
Fiscal year:	*Millions*
1982	$0.4
1983	.7
1984	.7
1985	.8
1986	.8
Estimated outlays:	
Fiscal year:	
1982	.4
1983	.7
1984	.7
1985	.8
1986	.8

The costs of this bill fall primarily within budget function 750.

6. Basis of estimate: For purposes of this estimate it is assumed that S. 708 would be enacted around December 1, 1981. Because this bill would modify the accounting standards of the Foreign Corrupt Practices Act of 1977, the Securities and Exchange (SEC) expects that fewer violations would likely occur, but that the additional reporting requirements specified by the bill would likely offset any reduced workload resulting from fewer violations of the Act.

S. 708 would also transfer from the SEC to the Department of Justice (DOJ) responsibility for enforcement of the bribery provisions of the Act. In addition, the bill would require the DOJ to revise guidelines and procedures for compliance. Based on information provided by the DOJ and allowing for phasing-in of the new guidelines and procedures beginning in March, 1982, it is estimated that $0.4 million would be required in fiscal year 1982 for this purpose. It is estimated that this cost would increase to $0.7 million in each fiscal year 1983 and 1984, and to $0.8 million in each fiscal year 1985 and 1986. The cost includes staff time for interagency coordination, and for issuing guidelines, reviewing procedures, assisting small businesses and enforcing additional civil investigations, plus overhead and travel. It was assumed that no net cost to the government would result from the transfer of civil enforcement authority for publicly-held corporations from the SEC to the DOJ.

7. Estimate comparison: None.

8. Previous CBO estimate: None.

9. Estimate prepared by: Mary Maginniss.

10. Estimate approved by:

C. G. NUCKOLS
(For James L. Blum,
Assistant Director for Budget Analysis).

REGULATORY IMPACT

Pursuant to Rule XXVI, paragraph 11(b) of the rules of the Senate, the Committee has evaluated the regulatory impact of the bill and concludes that it would result in a significant reduction in unnecessary regulatory burdens associated with the Foreign Corrupt Practices Act of 1977.

The principle purpose of S. 708 is to refine and clarify the Act in order to reduce the burden of compliance without undermining the purposes of the Act. Witnesses at the hearings held during consideration of the bill were nearly unanimous in believing that the regulatory costs associated with the Act have been excessive, and the amendments which would be made by the bill were identified by many witnesses as those needed to reduce the unnecessary regulatory impact. By amending the Act to provide more clarity and certainty about its meaning, the Committee expects to reduce substantially the costs associated with compliance.

CHANGES IN EXISTING LAW

In the opinion of the Committee, it is necessary to dispense with the requirements of Section 4 of Rule XXIX of the Standing Rules of the Senate in order to expedite the business of the Senate.

ADDITIONAL VIEWS OF SENATOR PROXMIRE

S. 708 amends the Foreign Corrupt Practices Act. Let me review for the Senate the history of the passage of the Act and my views of the alterations wrought by S. 708.

Congress enacted the FCPA in 1977 to put a stop to one of the worst corporate scandals in the history of the United States—a scandal which brutalized the reputation of American democracy overseas and had the most serious adverse foreign policy implications. Since the passage of the FCPA no foreign bribery scandal has tarnished our democracy abroad.

Domestically, the foreign bribery episode revealed major flaws in our domestic laws. Corporations were able to commit bribery abroad by the use of off-the-books slush-funds. The slush-funds escaped audit scrutiny by accounting firms because accounting standards were not strict enough to stop slush-fund bookkeeping. Worse yet, corporate managements were able to escape responsibility for the disbursement of company assets, in the hundreds of millions of dollars, on the ground that they did not know of the existence of the slush funds. The Securities and Exchange Commission stated that the almost universal characteristic of the bribery cases had been the frustration of our system of corporate accountability with millions of dollars of funds inaccurately recorded in corporate books and records. Before FCPA, bribery of foreign officials by American companies flourished. Bribery was accomplished by slush-fund bookkeeping in utter derogation of any rational system of internal accounting controls, occuring under the noses of senior management and outside accounting firms.

Some cynics might ask why should be concerned about the bribery of foreign government officials. I believe we should be concerned.

Bribery destroys free markets. When goods are bought and sold on the basis of bribes paid, not on price, quality and service, the free market is distorted. In every industry in which bribes were paid, companies found it profitable to do business everywhere in the world without bribery. Bribing companies gained a competitive edge over their own domestic competitors, an edge not based on market economics. By perverting the free market the bribers caused large segments of the investing public to lose faith in the integrity of the world's greatest capital market. Moreover, bribery corrupted developing democratic institutions in the Third World. At a time when the United States needs to encourage developing democracies, bribery undermines confidence in the democratic process.

FCPA attempted to deal squarely with the breakdown in management control over corporate assets and the failure of audit control by requiring companies subject to the jurisdiction of the SEC to maintain accurate records and internal accounting control systems under reasonable standards. FCPA also made it illegal for a company to bribe a foreign government official and made it illegal to make a payment to a sales agent where the company knew or had reason to know that all or a part of the payment would be passed on to the foreign government official.

What has happened since enactment of FCPA? For one thing this country has not suffered one instance of the bribery that so sullied our foreign policy before FCPA enactment. Since the anti-bribery bill became law in 1977, exports have sharply increased. They have grown much more rapidly than our gross national product. The anecdotes set forth in the Majority Report to the contrary simply are not persuasive evidence stacked against the facts. According to the testimony of the Treasury Department our export position has improved dramatically over the past four years. Unquestionably, a reputation of integrity never hurt a sale.

FCPA is a good law. The evidence indicates it has stopped slush-fund bookkeeping by American companies and has stopped corruption of foreign government officials by U.S. corporations. Now comes S. 708. What does S. 708 do to FCPA? S. 708 makes some sophisticated changes in FCPA. At first blush some of the changes appear to be reasonable. On reflecting on the changes in the light of the explanations provided in the Majority Report, however, I have concluded that S. 708 may circumscribe the proscriptions of FCPA. My concern is that if the Senate passes S. 708 as explained in the Majority Report, it runs substantial risk that bribery overseas will once again take place.

1. FCPA contains accounting provisions that stop-slush fund bookkeeping. S. 708 amends the FCPA accounting controls to make clear that the obligation to make and keep accurate books and records in reasonable detail is an integral part of the obligation to provide internal accounting controls that enable management to maintain accountability for assets. At the mark-up on S. 708, the Committee deleted the "materiality" standard in S. 708 as introduced, which standard, if adopted, would have been an utter disaster. So far so good. Combining in a single section the requirement that an issuer make and keep accurate and fair books and records in reasonable detail for the purposes of, among others, enabling it to prepare financial statements in accordance with generally accepted accounting principles and to maintain accountability for assets under the internal accounting controls section, by the Committee, reflects the view that accurate books and records are essential ingredients of any effective internal accounting control system. The internal accounting control system, including accounting records, required by S. 708, as reported by the Committee, is one that meets the standard of reasonable assurances that the purposes of the statute are fulfilled; namely that a company's execution of transactions, its recordation of transactions, its accountability for assets, its access to assets, and its recorded accountability for assets, will be accomplished by keeping accurate accounting records in such level of detail that would satisfy prudent individuals in the conduct of their own affairs, having in mind a comparison between benefits to be obtained and costs to be incurred in obtaining such benefits.

The statute approved by the Committee would allow enforcement of the accounting provisions in four separate instances as follows: (1) for "knowing falsifications" of accounting records, (2) for "knowing failures" to keep accounting records, (3) for "knowing" failures to maintain accounting controls and (4) for "knowing" attempts to circumvent accounting controls. Each of these instances are subject to independent and separate legal action according to the crystal clear and plain meaning of the statutory language adopted by the Committee. Notwithstanding this clarity, the Majority Report attempts to rewrite the statute by interpretation in derogation of the plain meaning of the statute by precluding the possibility of independent enforcement action in two of the four instances set forth above, namely, action based on a knowing falsification of accounting records or action based on a knowing failure to keep accounting records. This erroneous interpretation has no basis whatsoever in the statute which clearly provides for separate and independent causes of action in each of the four instances I have set forth. I am concerned that the language of the Majority Report may encourage lax accounting practices and attempts to immunize deliberate falsification of records.

I am also seriously concerned with the Committee's adoption of a knowing standard. The internal accounting control sections require that a company adhere to a standard of reasonableness in establishing and maintaining adequate internal control systems that fulfill all of the purposes of the statute. Enforcement should be available where the standard of reasonableness is not met, pure and simple.

A very serious problem is also raised by the interpretation of the term "knowing" in the Majority Report. The Majority Report states that enforcement for violations is only available where there is a "conscious awareness" of a violation or wrongdoing beyond negligence. The Majority Report interpretation would thus engraft an element of intent on the civil sanctions under the statute that would for practical purposes attempt to ensure that many serious violations of the accounting sections would not be enforced. While such an intentional standard is appropriate for criminal prosecutions it is wholly inappropriate to civil enforcement. I am concerned that the strained and incorrect interpretation of the term "knowingly" in the Majority Report may encourage slipshod accounting controls and recordkeeping and encourage circumventions of such controls by companies.

The interpreted standard of enforcement, set forth in the Majority Report, thus attempts to enfeeble the coverage of the accounting sections. Slush-funds may be established in violation of the section, but senior management could hide behind the argument that they did not "know." The Majority Report interpretation would allow managers to put their head in the executive sand and claim they did not know. The interpretation in the Majority Report is unjustified. The reliance in the Majority Report on outside auditors as insurers of accurate recordkeeping is not well placed. The obligation is on the corporation to maintain accurate records. Outside auditor's performance did not prevent slush-fund bookkeeping before passage of FCPA and is no substitute for requiring corporations to meet the reasonable standards of the statute now.

2. FCPA prohibits payments to agents where a company knows or has reason to know that all or a portion of the payment will be passed

on to a foreign government official. S. 708 eliminates this standard. In its place S. 708 proscribes only payments to foreign government officials through agents directed or authorized by a company expressly or by course of conduct. This is an amplified version of the original S. 708 direct or authorize standard. Here is what a number of key witnesses said about the "direct or authorize" standard itself at the hearings.

Harold Williams (former Chairman of the SEC):

> I am concerned with the pending bill's deletion of reason to know standard from the Act. If enacted with this deletion, it would be possible for management to adopt the "shut eyed" approach whereby liability would be avoided by remaining oblivious to the actual facts and circumstances underlying the subject transactions. Further, it would encourage a form of managerial irresponsibility that should not be the underlying effect of federal legislation and would give rise to an environment of do what you need to do, just don't tell me.

Ted Sorenson (former Assistant to President Kennedy) in speaking of the S. 708 ban on directed or authorized payments:

> Surely that invites a wide-open return to the knowing wink and the pregnant nod by not including those who knowingly aid or abet such payments.

Philip B. Heymann (former Assistant Attorney General, Criminal Division, Justice Department):

> I think the language of authorize or direct will allow the business of bagmen to flourish.
>
> The language which holds the corporation responsible only if it authorized or directed—I think they never do, never did, and never will authorize and direct at a high level of the corporation. And yet, bribes did go on, and therefore, I fear will go on again.

At mark-up, the Committee modified the "direct or authorize" language by including the words "expressly or by course of conduct." The question is whether the addition of these words to the "directs or authorize" language cures the substantial defects testified to by the witnesses. I recognize that the Committee made a valid effort to deal with the problem. But the question remains.

Certainly the term "expressly" makes the direct or authorize standard tougher by requiring express direction or authorization. So we are left with course of conduct. Does knowledge that an agent would pay a bribe on behalf of the company satisfy the course of conduct standard? The Majority Report is silent on the issue. Does this indicate that knowledge is or is not intended to be actionable? What if a reasonable person in the circumstances should have known that a bribe would be paid? Is an excessive payment made to an agent in reckless disregard of the facts by a company where a bribe was subsequently paid actionable? Unfortunately, the Majority Report again is silent on these issues, although I find very helpful the statement in the Majority Report that the direct or authorize expressly or by course of conduct language is intended to apply the same standard that applies to domestic bribery to foreign bribery, which of course covers conspiracy and liability for the acts of an agent within the scope of his employment. As Philip B. Heymann, former Assistant Attorney General in charge of the Criminal Division of the Justice Department, said before the Committee in testimony: "A corporation is responsible when one of its agents pays a bribe in furtherance of his own marketing activity. There is no requirement under normal law that anybody such as the board of directors, the Chairman of the Board, the president, the vice-president, the executive committee, approve, authorize, direct, the bribe." Nevertheless I am troubled that under the Majority Report language of S. 708, there is a risk that some cases may go unpunished where bribes are paid but astute counsel makes sure that even though the company knew or had reason to know of bribes it did not direct or authorize expressly or by course of conduct.

3. FCPA gives the SEC the authority to enforce by civil suit the bribery laws against companies subject to their jurisdiction. S. 708 takes this civil jurisdiction away from the SEC and transfers it to the Justice Department which would then have exclusively both civil and criminal jurisdiction.

There is no good public policy reason for stripping the SEC of its civil jurisdiction. The SEC has the expertise in the foreign payments area of the law. It was the SEC not the Justice Department which uncovered and prosecuted the foreign bribery scandal. The SEC has an ongoing relationship with corporations that issue stock. The Justice Department does not. The existing arrangement has worked out fine in practice. Is the SEC being stripped of its power because it pursued its mandate to protect the public interest?

For the reasons stated I have significant reservations concerning the passage of S. 708 in its present form. I hope the Senate will give this matter the most serious consideration. Certainly further clarification of S. 708 is needed before this measure is sent to the House.

WILLIAM PROXMIRE.

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