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BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Impact Of Foreign Corrupt Practices Act On U.S. Business

A GAO questionnaire survey of 250 companies randomly selected from the Fortune 1000 list of the largest U.S. industrial firms shows that the Foreign Corrupt Practices Act has brought about efforts to strengthen corporate codes of conduct and systems of internal accounting controls.

There is, however, extensive dissatisfaction with the clarity of the act's accounting provisions. Controversy exists over whether the provisions contain a materiality standard--a threshold for financial disclosure that limits management's reporting responsibilities to only material items. The GAO survey shows that business believes compliance is unreasonable without a materiality standard. The act's antibribery provisions have also been criticized as being vague and ambiguous. Further, companies believe they are suffering a competitive disadvantage due to the lack of an international antibribery agreement.

GAO recommends actions that the Congress and appropriate Government agencies can take to resolve issues caused by the act.

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MARCH 4,

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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To the President of the Senate and the
Speaker of the House of Representatives

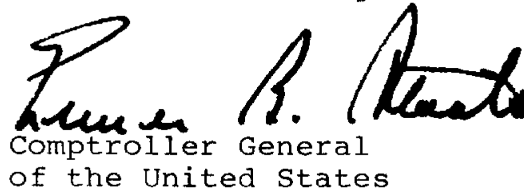
The Foreign Corrupt Practices Act has brought about changes in corporate codes of conduct and systems of internal accounting controls which should strengthen corporate accountability over assets and reduce the occurrence of questionable corporate activities. However, many companies believe the cost of complying with the act exceeds the benefits derived. The act has also been cited as causing U.S. companies to lose foreign business.

The act's accounting provisions have been criticized as being vague, and business believes that without a materiality standard compliance is unreasonable. Ambiguities surrounding the act's antibribery provisions have been cited as causing U.S. companies to forego legitimate export opportunities.

Attempts to clarify the act's provisions are underway; however, uncertainty continues and the materiality issue remains unresolved.

We are recommending that the Congress amend the Foreign Corrupt Practices Act to repeal the criminal penalties associated with violations of the accounting provisions. We are also recommending certain actions for the Securities and Exchange Commission and the Attorney General to take to address the business community's claims that the act is unclear and unreasonable.

We are also sending copies of this report to the Director, Office of Management and Budget; the Attorney General; the Secretaries of Commerce and State; the U.S. Trade Representative; and the Chairman, Securities and Exchange Commission.



Comptroller General
of the United States

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

IMPACT OF FOREIGN CORRUPT PRACTICES ACT ON U.S. BUSINESS

DIGEST

In response to widespread questionable corporate payments, the Congress enacted the Foreign Corrupt Practices Act in December 1977. The act's impact is much broader than is suggested by its title. The law, which makes offering payments to foreign officials to obtain or influence business illegal, also contains significant internal accounting control objectives and recordkeeping requirements. The accounting provisions were enacted because the Securities and Exchange Commission (SEC) had found that millions of dollars had been inaccurately recorded in corporate books and records to facilitate bribery. The accounting provisions, which are to operate in tandem with the antibribery provisions, apply regardless of whether or not a company has overseas business.

The act's accounting and antibribery provisions have generated substantial changes in corporate activities. Overall, these changes should strengthen the system of corporate accountability and reduce the occurrence of questionable corporate payments. However, about 55 percent of the companies completing a GAO questionnaire believe efforts to comply with the act's accounting provisions have cost more than the benefits received. In addition, more than 30 percent of the respondents engaged in foreign business cited the antibribery provisions as a cause of U.S. companies losing foreign business.

The lack of clarity of the accounting provisions has created widespread dissatisfaction, and controversy exists over whether the provisions contain a materiality standard--a threshold for financial disclosure which limits management's reporting responsibilities to only material items. Business believes that without a materiality standard, expecting compliance is unreasonable. The antibribery provisions have also been criticized as being vague and ambiguous. These ambiguities have been cited as a possible cause of U.S. businesses forgoing legitimate export opportunities. Further, companies believe they are suffering a competitive disadvantage without an international antibribery agreement.

derived is due, in part, to uncertainty over what constitutes compliance. The provisions are subjective and can therefore be interpreted differently. Guidance provided by the accounting profession and, in particular, recent guidance by SEC should alleviate some of the confusion. (See pp. 20-25.)

Compounding the uncertainty is the controversy over whether the accounting provisions include a materiality standard. An American Bar Association committee guide to the act indicates that a materiality standard exists, while SEC has stated that a "reasonableness" standard governs. Irrespective of whether a materiality standard exists, it is widely held by the business community that without a materiality standard, unnecessary compliance costs are incurred.

GAO believes that SEC, to help companies avoid unnecessary compliance costs, should provide business with further guidance on the factors and criteria that will be considered in assessing reasonableness. However, GAO believes that because the act addresses the subject of corporate accountability over assets, the traditional standard of materiality related to the disclosure of financial information is not appropriate. SEC must elicit the views of and work closely with business and the accounting profession in determining what additional guidance is needed and the format of the guidance. (See pp. 25-31.)

Further, the accounting provisions call for management judgment covering diverse and oftentimes complex recordkeeping and internal control systems. The provisions, even with additional guidance from SEC on compliance, will still, by their nature, require highly subjective determinations. GAO views the fear of criminal reprisals for accounting errors and control weaknesses that are not related to improper payments as a reason that companies incur unnecessary compliance costs and believes that the criminal penalties should be repealed. (See pp. 31-33.)

ISSUES SURROUNDING THE ANTIBRIBERY PROVISIONS

The antibribery provisions have also been criticized as being ambiguous about what constitutes compliance. In particular, companies that have reported a decrease in overseas business as a result of the act are highly critical of the clarity of the antibribery provisions. These

constitutes compliance with the antibribery provisions, alternative ways of addressing the ambiguities should be developed.

RECOMMENDATIONS TO THE CONGRESS

GAO recommends that the Congress amend the Foreign Corrupt Practices Act to repeal the criminal penalties associated with the act's accounting provisions. Enforcement of the accounting provisions' recordkeeping standards and internal control objectives would be through SEC civil action. However, there is still the matter of those flagrant abuses that gave rise to the act, such as the maintenance of off-books slush funds. To insure that adequate deterrents to these types of abuses exist, GAO recommends that the Congress consider legislation to establish criminal penalties for the knowing and willful falsification of corporate books and records.

GAO also recommends that the Congress closely monitor the status of U.S. efforts to reach an international antibribery agreement, and that the Congress urge the President to pursue the negotiation of such an agreement. GAO further recommends that the Congress hold hearings to address problems with the accounting as well as the antibribery provisions of the act. (See pp. 35 and 48.)

RECOMMENDATIONS TO THE SECURITIES AND EXCHANGE COMMISSION

GAO recommends that the Chairman of SEC--with input from the Departments of Justice and Commerce, the corporate community, and the accounting profession--provide guidance to business on the factors and criteria that will be considered in assessing reasonableness. This guidance could take the form of hypothetical situations or actual examples, or could specify actions that would be indicative of reasonable action to comply with the accounting provisions. SEC should find out the areas in which business needs further guidance and should seek its comments before finalizing the guidance. Management judgment will remain of prime importance, but business should have a better awareness of what reasonableness means to SEC.

GAO also recommends that, because of the importance of the act and of the uncertainty and controversy surrounding the accounting provisions, the Chairman report to the cognizant congressional committees on efforts to provide additional guidance by June 30, 1981. (See p. 35.)

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CHAPTER 1

PERSPECTIVE

Beginning in 1973--as a result of the work of the Office of the Watergate Special Prosecutor--the Securities and Exchange Commission (SEC) became aware of a pattern of conduct involving the use of corporate funds for illegal domestic political contributions. Subsequent SEC investigations and enforcement actions revealed that instances of undisclosed questionable or illegal corporate payments, both domestic and foreign, were widespread.

SEC announced a program in 1975 whereby companies could voluntarily disclose questionable activities. Under this program more than 450 corporations admitted making questionable or illegal payments exceeding $300 million.

PASSAGE OF THE FOREIGN CORRUPT PRACTICES ACT

The disclosures of widespread corporate bribery of foreign officials initiated the congressional action which eventually resulted in the December 19, 1977, passage of the Foreign Corrupt Practices Act of 1977 (Public Law 95-213--title I). Reports that accompanied the House and Senate versions of the act clearly indicated that the Congress perceived corporate bribes to foreign officials as (1) unethical, (2) unnecessary to the successful conduct of business, and (3) harmful to our relations with foreign governments.

In addition to addressing the bribery issue, the Congress also responded to SEC's recommendation that legislation be enacted that would enhance the accuracy of corporate books and records and strengthen corporate systems of internal accounting control. These legislative changes were intended to operate in tandem with the act's other provisions to deter corporate bribery. SEC found that millions of dollars had been inaccurately recorded in corporate books and records to facilitate making bribes. The falsification of these records was known to corporate employees and often to top management.

REQUIREMENTS OF THE ACT

The Foreign Corrupt Practices Act is a significant and far-reaching law regulating the conduct of American business in foreign countries. However, it covers a much broader area than is suggested by its title. The act is not limited to companies doing business abroad, nor is it restricted to corrupt payments. It contains significant internal accounting control objectives and recordkeeping requirements that go beyond corrupt foreign payments.

The act contains two important segments: (1) an antibribery prohibition and (2) standards for maintaining records and

The recordkeeping standard requires that a company's books, records, and accounts, in reasonable detail, accurately and fairly reflect its transactions and the disposition of its assets. The internal accounting control provision requires that a company's system of internal accounting controls be sufficient to provide reasonable assurances that certain control objectives are met.

SEC registrants and any person authorized to control the direction, management, and policies of a corporation who willfully violate the accounting provisions are subject to the general penalties imposed by the Securities Exchange Act of 1934. These penalties include a fine of up to $10,000 and imprisonment for up to 5 years, or depending upon the circumstances, a violation may result in an SEC civil enforcement action.

SHARED RESPONSIBILITY FOR ENFORCEMENT

SEC and the Department of Justice share responsibility for enforcing the act. SEC is responsible for conducting investigations of SEC registrants suspected of violating the antibribery and accounting provisions. SEC can bring civil actions against these violators and/or refer them to Justice for criminal prosecution. Justice is also responsible for proceeding civilly and criminally against domestic concerns alleged to have violated the antibribery provisions.

OBJECTIVES, SCOPE, AND METHODOLOGY

We initiated this review to obtain the data we believe the Congress needs to assess the implementation and impact of the Foreign Corrupt Practices Act. We used survey and statistical sampling techniques to obtain information from the corporate community. We also interviewed officials of the accounting profession, the legal profession, business and public interest groups, and cognizant Federal agencies.

Corporate survey and sampling methodology

Our basis for all sampling was Fortune's list of the 1,000 largest industrial firms. We randomly selected 125 companies from Fortune's list of the 500 largest U.S. industrial firms and 125 companies from its list of the 500 second largest firms. In 1978, sales for the top 500 firms ranged from $379 million to $63 billion. Sales for the second 500 firms ranged from $110 million to $379 million. The statistical certainty of the sample is such that there is a 95 in a 100 chance that projections of the sampling results to the universe will not be off by more than 7 percent.

In addition, we reviewed articles and publications dealing with the Foreign Corrupt Practices Act, including a study of internal control in U.S. corporations conducted for the Financial Executives Research Foundation.

We discussed the enforcement of the act with SEC and Justice officials and examined documentation relating to enforcement activities. We also interviewed officials from the Overseas Private Investment Corporation and from the Departments of Commerce, the Treasury, and State regarding the clarity of the act's provisions and the act's impact on U.S. corporate foreign sales. We also reviewed the February 1980 report of the White House task force on export disincentives, the September 1980 report prepared by the Department of Commerce and Office of the U.S. Trade Representative on export promotion functions and potential export disincentives and the December 1980 report by the President's Export Council. These reports discuss the impact and problems related to the act. We also reviewed the status of United Nations efforts to promulgate an international antibribery agreement.

Because of corporate perceptions that the act had more adversely affected the overseas business of U.S. aircraft and construction companies, we also conducted a limited survey of leading companies in these industries. The survey results are discussed separately and not in conjunction with the results of our sampling of Fortune's top 1,000 industrials.

Corporate codes address many areas

Corporate codes of conduct cover many areas of employee behavior. Our questionnaire, however, was limited to areas specifically addressed by the act which cover

- --questionable practices, improprieties, or negligence in using corporate funds and
- --responsibilities for complete and accurate transaction reporting.

About 90 percent of our respondents reported that they have written codes addressing these areas. Examples of conduct addressed by these codes follow.

Type of conduct	Percent of respondents with codes addressing the conduct
Using corporate funds for political contributions	96
Making questionable or improper foreign payments	94
Failing to record financial transactions	91
Making false entries on company books or records	90
Failing to secure proper authorization for transactions	83

For companies responding that they had written codes, no significant differences existed between those in the top 500 industrials and those in the second 500 as to the codes' contents. However, 13 percent of the respondents from the second 500 reported they had no written codes compared with only 1 percent of the respondents from the top 500 firms.

Written codes of conduct are not new to the corporate community. One major manufacturing firm, for instance, has had a code for more than 40 years. However, our questionnaire responses showed that the act has made companies more aware of the importance of and their responsibility for developing corporate policies and standards for conducting business.

Changes made in codes before the act was passed

In addition to the widespread changes in corporate codes of conduct resulting from the act, substantial changes were made in the 4 years before the act's passage. During this prior period, questionable corporate payments and practices were frequently revealed.

More than 50 percent of our respondents reported making changes in their codes during this turbulent period; 25 percent did not find it necessary to make any further changes as a result of the act. Important changes were most frequently made in the following areas:

--Questionable or improper foreign payments.

--Domestic or foreign bribes.

--Use of corporate funds for political contributions.

SUBSTANTIAL CHANGES IN INTERNAL ACCOUNTING CONTROL SYSTEMS HAVE OCCURRED

Internal accounting controls constitute the plan of organization and all the methods and procedures dealing with the safeguarding of assets and the reliability of financial records. Effective systems of internal accounting control are an important requisite of good corporate management. With passage of the act, this requisite became a legal requirement causing most companies to review and change their audit and control procedures and practices.

Almost all the questionnaire respondents reported that the act has caused them to review the adequacy of their audit and control procedures and practices. More than 75 percent of these respondents reported making changes. Extensive changes were made in the following areas:

--Documenting internal accounting control.

--Testing internal accounting control systems.

--Strengthening internal audit.

--Performing special reviews to identify areas where certain types of policy violations are likely to occur.

In addition, in the last few years, the use of audit committees to strengthen the system of corporate accountability has grown phenomenally.

being followed and assists in improving and developing internal accounting control systems.

Over 20 percent of the respondents said that to a moderate or a great extent, they have increased their internal audit staffs' (1) responsibility, (2) size, (3) training, and (4) independence from management.

These changes were confirmed by officials of the public accounting firms we visited. One official, for example, stated that since the act, many companies have expanded their recruitment of accounting graduates. The increased opportunities for internal auditors prompted the Wall Street Journal to refer to the Foreign Corrupt Practices Act as the "Internal Auditor Full Employment Act of 1977." Not only are more internal auditors being hired, but their corporate stature--particularly that of directors of internal audit--is changing. The public accounting officials contacted stated that many companies view their directors of internal audit as key management members.

Both the accounting profession and SEC have stressed the importance of an effective internal audit as a means of complying with the act. For instance, one accounting firm recommended that management, in evaluating internal accounting control, determine whether its internal auditors are properly trained and organized to monitor compliance with the act's provisions. The SEC Chairman believes that internal accounting control is an area where the depth and breadth of an internal auditor's knowledge should not be rivaled by anyone inside or outside the company.

The Financial Executives Research Foundation research study confirmed the increased importance of internal audit. Its study concluded that the act has made internal auditors more visible and influential in a company. The study revealed that, in recent years, most companies have increased their internal audit staffs at a faster rate than the company's real growth and that no reduction in the growth of internal audit is expected.

Greater use of special reviews

Our corporate respondents reported that because of the act more special reviews or investigations have been conducted to identify areas or situations where certain types of violations covered by the act are likely to occur. These reviews are performed in addition to normal audits. For instance, a company may have its internal and/or independent auditors perform a special study of the system of internal accounting controls to determine if any weaknesses exist and how they may affect the company's financial records and the safeguarding of assets.

About 55 percent of the respondents reported that since the act they have conducted special reviews to identify areas or situations where questionable or improper foreign payments and/or

THE COST OF COMPLYING WITH THE ACT'S ACCOUNTING PROVISIONS IS PERCEIVED TO EXCEED BENEFITS

As discussed above, corporate systems of internal accounting control have undergone extensive change. In many cases, however, these compliance efforts were perceived as costing more than the benefits received.

About 55 percent of the questionnaire respondents reported that their compliance efforts have resulted in costs that exceeded the benefits. The remaining 45 percent did not believe this to be the case. For the respondents who reported that the costs incurred exceeded the benefits, the extent of the cost burden varied as follows:

--50 percent believed the burden has increased their accounting and auditing costs by 11 to 35 percent.

--22 percent reported that the burden has increased their accounting and auditing costs more than 35 percent.

--28 percent estimated the cost burden at less than 11 percent.

In their study of internal control, the Financial Executives Research Foundation researchers also found that companies perceived certain changes as cost burdens. According to the study report, executives believe that their compliance programs often involve significant costs with noncommensurate benefits in terms of improved controls and recordkeeping. One such change was the increased emphasis on the documentation of internal accounting control systems. The foundation study noted that some corporate officials believed that the increased documentation was a paper-gathering exercise to serve as a defense against SEC inquiries.

In part, the perception that there is a cost burden may be due to the subjectivity inherent in determining what constitutes compliance with the act and to the limitations in performing a cost-benefit analysis. The legislative history of the act states that management must estimate and evaluate the costs and benefits of compliance efforts. Cost-benefit analysis, however, is not a precise science. Reasonable individuals with good judgment and intentions can differ in their opinions. However, if that difference in opinion is with SEC, a company could be vulnerable to an enforcement proceeding.

In their study of internal controls, the Financial Executives Research Foundation researchers found that an objective measure of either costs or benefits is rarely feasible. The study noted that this poses a dilemma to executives in deciding upon a strategy for complying with the act. The study concluded that

Business' perception of the act's impact on overseas sales

Although the majority of our questionnaire respondents reported that the act has had little or no effect on their overseas business, more than 30 percent of our respondents engaged in foreign business reported they had lost overseas business as a result of the act. In addition, over 60 percent reported that, assuming all other conditions were similar, American companies could not successfully compete abroad against foreign competitors that were bribing.

Almost all the respondents that reported decreases in business stated that the act had discouraged foreign buyers and agents from doing business with their firms. In some countries, the use of foreign agents is a recommended practice; in other countries, it is necessary. About 45 percent of the respondents that reported lost business stated that the act has limited the number of countries in which they do business. The impact on overseas business was felt more by respondents from the top 500 companies. Whereas 25 percent of the respondents from the second 500 reported decreases in business, about 42 percent of the top 500 respondents reported losses.

How much the act can affect a company's overseas sales is influenced by many factors, including:

--The country in which the company conducts its business.

--The type of product or service it sells.

--The identity of the purchasers (government versus non-government).

--The business practices of its competitors.

--The honesty of foreign government officials.

--Whether or not the company previously made questionable payments to obtain foreign business.

Our respondents believed that companies in the construction and aircraft industries were more likely to be adversely affected by the act. Because of these perceptions, we sent additional questionnaires to a number of leading companies in these industries. The response rate of these two samples was slightly lower than that of our overall sample; 13 of 20 aircraft companies and 15 of 25 construction firms responded. However, those responding supported the perception that the aircraft and construction industries have been significantly affected by the act; 54 percent reported that the act had adversely affected their overseas business.

In February 1980, SEC requested public comment concerning the impact of the act's antibribery provisions and any impediments they present to legitimate foreign business. In its release asking for comment, SEC emphasized that it had no empirical evidence concerning the actual impact of the act on business. Although our corporate sample showed that more than 30 percent of the respondents engaged in foreign business had lost business overseas as a result of the act, SEC received only 14 replies. However, the majority of SEC's respondents indicated that the act's ambiguities were causing U.S. firms to forgo foreign business.

Further complicating quantification of the act's impact is that American exports have increased since the act, even in those areas where the White House task force reported that the act has had a significantly negative impact. A Department of Commerce official, however, stated that increased exports were due to other factors, such as the dollar devaluation, which made American goods cheaper to foreign buyers. The official added that the export increase would have been significantly greater if it were not for the Foreign Corrupt Practices Act.

As discussed above, the act is viewed as only one of many export disincentives. The task force, in considering 14 disincentives, could not isolate and measure the impact of individual ones. However, the perception is important--American companies believe that the act puts them at a competitive disadvantage overseas.

CONCLUSIONS

The Foreign Corrupt Practices Act has resulted in widespread and important changes in corporate codes of conduct and systems of internal accounting control. Overall, these changes should strengthen the system of corporate accountability and thereby reduce the number of questionable corporate payments and practices.

However, not all these changes are perceived as being beneficial. Many corporate officials believe that the costs incurred to comply with the act's accounting provisions exceed the benefits received. The act is also perceived as having caused some U.S. companies, particularly companies in the aircraft and construction industries, to lose business overseas.

The cost burden associated with the accounting provisions is due in part to uncertainty over what constitutes compliance. Affecting this uncertainty is the controversy over whether the provisions contain a materiality standard--a threshold for financial disclosure which limits management's reporting responsibilities to only material items. Both these issues are discussed in detail in chapter 3.

CHAPTER 3

CONTROVERSY AND CONFUSION OVER THE ACT'S ACCOUNTING PROVISIONS

Since their enactment, the act's accounting provisions have been steeped in controversy and confusion. The business community has criticized them as being too vague to provide guidance on how sophisticated an accounting system must be to comply. In addition, SEC and an American Bar Association (ABA) committee disagree on whether the provisions contain a materiality standard--a threshold for financial disclosure which limits management's reporting responsibilities to only material items. The ABA committee indicates that the act does contain a materiality standard; SEC says that a "reasonableness" standard governs. Without a materiality standard, compliance is perceived by business as too costly.

Although using familiar accounting terms, the act's accounting provisions are inherently subjective and can be interpreted differently. Guidance provided by the accounting profession and SEC, however, should alleviate some of the uncertainty; especially a recent policy statement by SEC on the accounting provisions.

Irrespective of whether a materiality standard exists, the business community at large believes that one is needed. To help companies avoid unnecessary compliance costs, we believe that SEC should provide further guidance to business on the factors and criteria that will be considered in assessing reasonableness. However, given the intent of the act's accounting provisions to improve corporate accountability over assets, we believe the traditional standard of materiality related to financial disclosure is not appropriate. SEC must elicit the views of and work closely with both the corporate community and the accounting profession in determining what additional guidance is needed and in determining the format of the guidance.

Another reason that companies are incurring unnecessary compliance costs is their apprehension over the potential application of criminal penalties to what are essentially intended to be management judgments covering diverse and oftentimes complex recordkeeping and internal control systems. These are highly subjective determinations, even with the additional guidance we call for SEC to develop. We believe that the Congress should repeal the criminal sanctions associated with the accounting provisions to ensure that business can better work toward cost-effective compliance.

what constitutes compliance. Although the act uses familiar accounting and auditing terms, critics emphasize that it lacks objective criteria for determining whether a recordkeeping or internal control deficiency is a violation. Much confusion exists over terms such as "reasonable assurances" and "in reasonable detail." Coupled with the lack of a materiality standard, which is discussed on pages 25 to 31, business perceives the act to be too costly.

The accounting profession and SEC have provided some guidance to companies on how to comply with the accounting provisions, which should alleviate some of the uncertainty. An element of uncertainty, however, will probably always exist due to the inherent subjectivity of accounting terms.

The accounting provisions have been criticized as unclear

There is extensive dissatisfaction with the clarity of these provisions. Our corporate sample, leading public accounting firms, and the previously mentioned Financial Executives Research Foundation study all give the provisions low marks for clarity.

Over 30 percent of our questionnaire respondents rated the recordkeeping provision as inadequate, and over 50 percent rated the concept of "reasonable assurance" as inadequate.

The respondents indicated that greater specificity is needed. One respondent commented that the accounting provisions are stated in very broad terms which are difficult to apply to specific situations. Another commented that the provisions are very subjective; there is no method for determining what is a sufficient system of internal accounting control and no general consensus on the definition of "reasonable assurance."

The leading public accounting firms reported similar views. They were concerned that the act provides no guidance on what constitutes a violation of the accounting provisions. One firm commented that deciding whether a company's recordkeeping is accurate and reflects matters fairly, or whether a system of internal accounting controls provides reasonable assurances, involves complexities and uncertainties that make it difficult, if not impossible, to determine whether a company has complied with the act. Another firm was concerned that because of the absence of standards for determining compliance, management's view of how accurate its records need to be may differ significantly from the degree of accuracy the act may require. Many firms were critical of the fact that although the "reasonable

In August 1980, the AICPA issued its Statement on Auditing Standards, No. 30 entitled "Reporting on Internal Accounting Control." This new standard describes the procedures that should be applied in connection with various audit engagements to report on internal accounting controls--including publicly expressing an opinion on a client's overall internal accounting control system. The accountant's opinion does not indicate whether the company is in compliance with the act's accounting provisions because the AICPA believes that determining such compliance is a legal matter. Statement on Auditing Standards, No. 30 includes a materiality standard; whereas as discussed on pages 27 and 28 SEC believes the act includes a reasonableness standard. However, the AICPA indicates that the accountant's opinion may be helpful to management in evaluating the company's compliance. Also, an expert on auditing practices has been quoted as saying that the new standard will provide momentum by taking away the auditors' argument that they do not have guidelines for evaluating and reporting on internal controls.

To further diminish the uncertainty, on January 13, 1981, SEC's Chairman, in a speech before an AICPA conference, delivered a policy statement on the act's accounting provisions. This statement was issued 5 weeks after SEC received for comment our draft report which showed the seriousness of the controversy and the confusion in the business community over what constitutes compliance with the accounting provisions. The SEC Chairman stated that the anxieties created by the act among individuals of utmost good faith have been, in his experience, without equal. He said that uncertainty about those provisions can have a debilitating effect on the activities of those who seek to comply with the law and acknowledged that business may have incurred excessive costs in attempting to assure compliance with the act.

The Chairman indicated SEC's sensitivity to the concerns of business and provided an analysis of the act's provisions, addressing certain characteristics which SEC will consider in assessing compliance. For instance, the Chairman said that inadvertent recordkeeping mistakes will not result in SEC enforcement action. He also said that a company will not be subject to an injunction for falsifying its books and records where management, broadly defined, is not aware of such an action and could not reasonably have known of it. The Chairman reemphasized SEC's position that the reasonable standard applies. He added that a company need not always select the best or the most effective control measure but that the one selected must be reasonable under all circumstances. He said that the accounting provisions' principle objective is to reach incidents of knowing or reckless conduct. He expected that the courts will issue injunctions only when there is a reasonable likelihood that the misconduct will be repeated. In SEC's view this likelihood does not exist when the conduct in question is inadvertent.

impossible to enumerate specific controls that would answer every question and meet all the needs of every company.

CONTROVERSY OVER THE EXISTENCE OF A MATERIALITY STANDARD ADDS TO UNCERTAINTY

Increasing the uncertainty over what constitutes compliance is the controversy over whether the act's accounting provisions include a materiality standard. An American Bar Association committee's guide to the provisions indicates that the act contains a materiality standard; SEC says that a "reasonableness" standard governs.

Irrespective of whether a materiality standard exists, it is widely held that one is needed. Over 70 percent of our questionnaire respondents and all the accounting officials contacted believe that without a materiality standard, the amount and kind of effort required to comply with the accounting provisions is unclear.

SEC should provide further guidance to business on the factors and criteria that will be considered in assessing reasonableness so that companies can avoid unnecessary compliance costs. However, given the subject of the act's accounting provisions--improving corporate accountability over assets--the traditional standard of materiality related to financial disclosure is inappropriate. Therefore, SEC must elicit the views and work closely with the corporate community and the accounting profession, in determining what additional guidance is needed and the format of the guidance.

The traditional concept of materiality

This concept has long been considered a fundamental part of the financial accounting and reporting process. A materiality standard is imbedded in the securities laws, reflecting their primary objective of investor protection. By requiring full and fair disclosure of material information concerning publicly offered securities, investors are better able to make informed investment decisions.

Although materiality is a widely recognized term and some quantitative guides exist, an explicit standard of what constitutes materiality has yet to be formulated. Numerous factors are often considered in making materiality decisions affecting financial reporting, many of which are intuitive and involve professional judgment. However, broad definitions of "materiality," as well as quantitative guides for specific items, do exist.

these provisions, (2) their vagueness, (3) the complete lack of interpretative guidelines or experience with them, (4) the technical character of the field, and (5) the peculiar, almost accidental, character of their legislative origins.

The guide indicated that the act contained the traditional standard of materiality related to financial disclosures. The guide concluded that a company would not be in compliance with the "accurate books and records" provision if it could not prepare, from its books and records, financial statements that in all material respects conform with appropriate generally accepted accounting principles.

With respect to the act's internal accounting control requirements, the guide stated that an implied violation of these requirements would arise if a company's system of internal accounting control did not provide reasonable assurance that material irregularities or material errors in financial statements either would be prevented or would be detected and corrected promptly by employees in the normal course of business.

SEC believes no materiality standard exists

In contrast to ABA's position, SEC has stated that neither the "accurate books and records" provision nor the internal accounting control provision includes a materiality standard, but instead contains a "reasonableness" standard.

In a February 1979 release, SEC emphasized that the "accurate books and records" provision is qualified by the phrase "in reasonable detail" rather than by the concept of materiality. In discussing comments on a proposed rule concerning this provision, SEC said that limiting the rule's application to material falsifications of corporate books would unduly narrow its scope. SEC also said that the act does not require perfection, but that books, records, and accounts should be kept in reasonable detail to accurately and fairly reflect the transactions and dispositions of assets. SEC pointed to the legislative history of the act to support its position.

act, no practical system of internal control can assure management that prohibited practices will not occur, however small the amounts involved.

The public accounting firms we contacted also emphasized the need for a materiality standard. In response to the previously mentioned SEC-proposed rule requiring management to report on its system of internal accounting control--a requirement some see as a statement of compliance with the act--public accounting firms commented that:

--The inapplicability of a materiality standard creates the potential for limitless compliance costs and places the burden upon auditors, who lack the legal authority, to establish the parameters or criteria that SEC declines to set.

--Materiality is necessarily a factor in many cost-benefit decisions.

--Materiality is implicit in a cost-benefit test determination involving internal accounting controls.

The Financial Executives Institute, in its response to the proposed rule, stated that SEC's decision to specifically deny the use of a materiality standard in assessing internal accounting control is a major problem and should be reconsidered. The Institute believed the absence of a materiality threshold substantially enlarges the scope of effort and makes literal compliance virtually impossible. It further commented that reasonable assurance as a concept distinguished from materiality is a novel approach and is not well understood. In this regard, the previously mentioned AICPA Statement on Auditing Standards, No. 30 includes a materiality standard.

GAO's analysis of the need for a materiality standard

We believe that without guidance on the factors and criteria to be considered in assessing compliance against a reasonable standard, business may incur unnecessary compliance costs. To avoid the potential of noncompliance and possible enforcement action, companies may go to greater extremes in keeping books and establishing controls than the Congress intended. The act's legislative history indicates that the Congress did not intend to require companies to have perfect books and perfect systems of internal accounting control. Instead, the legislative

the SEC Chairman's policy statement. For instance, he said that inadvertent recordkeeping mistakes will not result in SEC enforcement actions. He also said that a company will not be subject to SEC enforcement action for falsifying its books and records where management, broadly defined, is not aware of and could not reasonably have known of such an incident. The Chairman's statement, however, did not specify the actions that would be indicative of compliance or discuss the factors and criteria that recordkeeping and internal control systems must meet.

To guide compliance SEC should provide a better awareness of what it perceives to be "reasonable." We do not intend that SEC promulgate requirements that may be burdensome or unrealistic. We do not believe that companies want an overly detailed checklist of actions that dictate how they must design their recordkeeping and internal control systems. The act's legislative history expressly calls for management judgment in developing systems of recordkeeping and internal control.

The staff of SEC presently issues guidance covering a wide range of accounting matters. This guidance includes specific examples of how various transactions can be handled and is intended to assist in the implementation of the Federal securities laws. The Federal Government also has standards for certain types of transactions. For example, Federal agencies are authorized by law to use statistical sampling in examining voucher payments of less than $300. Certain property can be excluded from being capitalized when the value does not exceed $300.

SEC should find out the areas in which the business community needs further guidance. Initially, it could do this by asking business for its views on what additional guidance is needed to comply with the reasonableness standard and what form this guidance should take. For instance, this guidance could take the form of hypothetical situations, actual examples, or interpretations, or could specify actions that would be indicative of reasonable action to comply with the accounting provisions. Management judgment will remain of primary importance, but business will be better aware of what SEC perceives constitutes compliance.

CRIMINAL PENALTIES ASSOCIATED WITH THE ACCOUNTING PROVISIONS SHOULD BE REPEALED

Another reason companies may be incurring excessive compliance costs is their apprehension over the potential application of criminal penalties to what are essentially intended to be management judgments over recordkeeping and internal control systems. The accounting

and perhaps criminal liability, as a result of technical and insignificant errors. He also stated that anxieties created by the act may have led business to develop overly burdensome compliance systems which extend beyond what is needed for sound management or intended by the act.

In commenting on our report, SEC stated that a criminal prosecution would be recommended to the Justice Department for violation of the act's accounting provisions only in the most egregious cases. In addition, SEC stressed that in the 3 years since the act was passed, it has yet to recommend criminal prosecution. Further, SEC pointed out that, in the six civil injunctive actions brought to date under the accounting provisions, there were also other violations of securities laws involved.

We strongly support the expressed intent of the act that business maintain accurate records and adequate systems of internal controls. However, we do not believe criminal penalties should be associated except for the most serious violations, such as the type of flagrant abuses that gave rise to the passage of the accounting provisions. Such abuses could best be addressed through new legislation which could expressly establish criminal penalties only in cases of flagrant abuse.

The existing criminal penalties attached to the accounting provisions should be repealed. This should substantially alleviate the business community's apprehension over the exposure to criminal liability for minor irregularities or control weaknesses of the accounting provisions. The Congress should consider legislation to establish criminal penalties for the knowing and willful falsification of corporate books and records. This would cover situations where corporate books and records were falsified for the purpose of aiding in or concealing the misuse of corporate assets.

LEGISLATION HAS BEEN INTRODUCED TO RESOLVE CONFUSION OVER THE ACCOUNTING PROVISIONS

Bills (H.R. 7479 and S. 2763) 1/ were introduced in the last session of the Congress to amend these provisions. We anticipate that these bills will be reintroduced in the near future. Supporters of these bills believe that although the act serves a legitimate, ethical need, it has inadvertently created unnecessary constraints because of the unclear nature of compliance.

The bills propose that the traditional materiality standard in terms of financial reporting be incorporated in the accounting provisions to make the act consistent with accounting requirements of the securities laws and to avoid unnecessary cost burdens.

1/ We sent comments on H.R. 7479 to the Chairman, House Committee on Interstate and Foreign Commerce (B-199500, Sept. 19, 1980).

subjective determinations. We view the fear of criminal reprisals for errors and control weaknesses that are not related to improper payments as a reason that companies may incur unnecessary compliance costs, and we, therefore, believe that the criminal penalties should be repealed.

RECOMMENDATIONS TO THE CONGRESS

We recommend that the Congress amend the Foreign Corrupt Practices Act to repeal the criminal penalties associated with the act's accounting provisions. Enforcement of the accounting provisions' recordkeeping standards and internal control objectives would be through SEC civil action. However, those flagrant types of abuses that gave rise to the act, such as the maintenance of off-books slush funds, are still a matter of concern. To insure that adequate deterrents to these types of abuses exist, we recommend that the Congress consider legislation to establish criminal penalties for the knowing and willful falsification of corporate books and records. We also recommend that the Congress hold hearings to address problems with the accounting as well as as the antibribery provisions of the act.

RECOMMENDATIONS TO SEC

We recommend that the Chairman of SEC, with input from Justice, Commerce, the corporate community, and the accounting profession, provide to business guidance on the factors and criteria that will be considered in assessing reasonableness. This guidance could take the form of hypothetical situations or actual examples, or could specify actions that would be indicative of reasonable action to comply with the accounting provisions. SEC should find out the areas in which business needs further guidance and should seek the comments of business before finalizing the guidance. Management judgment will remain of prime importance, but business should have a better awareness of what reasonableness means to SEC.

Because of the importance of the act and the controversy and uncertainty surrounding the accounting provisions, close congressional oversight is needed. Therefore, we also recommend that the Chairman report on efforts to provide guidance on compliance no later than June 30, 1981, to the Chairmen, Senate Committee on Banking, Housing, and Urban Affairs and House Committee on Energy and Foreign Commerce.

CHAPTER 4

ISSUES SURROUNDING THE ACT'S ANTIBRIBERY PROVISIONS

As with the accounting provisions, there is also confusion over what constitutes compliance with the act's antibribery provisions particularly by companies whose business has been adversely affected by the act. Ambiguities in these provisions have been cited as possibly causing U.S. companies to forgo legitimate export opportunities.

The majority of our corporate sample perceives that an international antibribery agreement would strengthen American companies' competitive position in foreign markets. No other nation has antibribery prohibitions similar to the Foreign Corrupt Practices Act.

To clarify the ambiguities in the act, the Justice Department implemented a program to provide advance guidance. However, this program, which has been used only nominally by businesses, has been criticized by some business and governmental officials as inadequate. The program has yet to effectively address the uncertainty and it is doubtful it will. We believe other alternatives are needed if the ambiguities are to be cleared up, and we offer several options.

Also, efforts since 1976 to reach an international antibribery prohibition have not been successful. The United States has recently mounted a new effort to negotiate an international agreement outside the United Nations, but the State Department is not optimistic that an effective agreement can be put into effect any time soon.

THE ACT'S ANTIBRIBERY PROVISIONS

The act's antibribery provisions prohibit both SEC registrants and domestic concerns from corruptly offering or giving anything of value to

--a foreign official, including any person acting in an official capacity for a foreign government;

--a foreign political party or party official; or

--a candidate for foreign political office.

The prohibition relates to offers or payments that are corruptly made to influence these officials in order to help a registrant or domestic concern obtain or retain business or to direct business to any person.

lawyers believe the "reason to know" standard increases the potential liability of a company for the acts of affiliated third parties, even though the company cannot fully monitor or control their activities.

This provision was cited as the area of greatest concern to business in a September 1980 report on export promotion functions and potential export disincentives prepared by the Department of Commerce and the Office of the U.S. Trade Representative. According to the report, the provision suggests that a company would be found to have reason to know when it ignored red flags. "Red flags" were defined as indications that would lead a reasonable person to believe that an agent was making a prohibited payment. Some companies and their attorneys are concerned that in countries where bribery of government officials is commonplace, reason to know will be presumed in all cases.

The report further stated that companies are uncertain about the extent to which they can insulate themselves from liability for the corrupt activities of agents by instituting control procedures designed to insure compliance with the act. The report added that many companies are concerned that they may be liable if bribery occurs even after they have instituted reasonable, prudent safeguards. According to the report, the effects of these ambiguities manifest themselves in various ways. It pointed out that discussions with the private sector had revealed instances when U.S. companies

--withdrew from joint ventures for fear they later could be held responsible for the acts of their foreign partners,

--incurred substantial legal and investigative costs to check the backgrounds of their sales agents abroad,

--could not obtain the services of effective sales agents,

--lost contracts simply because of the time needed to investigate sales agents and institute safeguards,

--withdrew from existing markets, and

--declined to enter new markets.

Definition of "foreign official"

The act defines a "foreign official" as any officer or employee of a foreign government or one of its departments, agencies, or instrumentalities, or any person acting in an official capacity for or on behalf of such government or department, agency, or instrumentality. The term "foreign official" excludes any employee whose duties are essentially ministerial or clerical. The distinction is important because facilitating payments to the latter officials are not prohibited.

prohibited, while a small payment to expedite processing of a customs form is prohibited if made to a more senior official.

Extortion versus bribery

Another area of uncertainty expressed by some businessmen we contacted concerns what they perceive as the fine line between extortion and bribery. This fine line was also cited in the export report prepared by Commerce and the Office of the U.S. Trade Representative.

The legislative history indicates that payments made as a result of threats of criminal violence to a company's plant are allowed on the grounds of extortion. For example, the Senate committee report states that a payment made to an official to keep an oil rig from being blown up should not be held to be made with any corrupt purposes.

However, some businessmen question whether economic extortion is covered. For example, does the act exempt payments made as a result of threats that are primarily economic, such as threats of expropriation or threats to cut off oil supplies?

THE DEPARTMENT OF JUSTICE GUIDANCE PROGRAM TO REDUCE UNCERTAINTY

President Carter expressed concern over the potential effect of the act's alleged ambiguities in September 1978--only 9 months after its passage. He stated that the act should not be viewed as an impediment to the conduct of legitimate business activities abroad. He hoped that business would not forgo legitimate export opportunities because of uncertainty about the application of the act. To reduce this uncertainty, he directed the Department of Justice to give the business community guidance concerning its enforcement intentions under the act.

On March 24, 1980--18 months after the President's directive--the Department of Justice implemented its long-awaited guidance program. Justice believes the program's review procedure will provide a mechanism for businessmen and attorneys to seek guidance about the meaning and application of the antibribery provisions.

The program has yet to effectively address the ambiguities, and it is doubtful it will. Its format has been criticized by some governmental and business officials, and it has been used only nominally by the business community. As of January 1981, only five companies had requested a review.

How the program works

The guidance program, entitled the "Foreign Corrupt Practices Act Review Procedure," allows a company to seek guidance on contemplated foreign transactions. The procedure is modeled after

The U.S. Chamber of Commerce has also criticized the Justice program. The Chamber, commenting on export disincentives, has stated that given the stringent requirements of the review procedures and the lack of protection from government investigation, it appears unlikely that companies will use the program. The Chamber of Commerce further stated that of the options for guidance under the program proposed by Commerce, Justice selected the one least onerous for itself, which was the least worthwhile for the business community.

The September 1980 report on exports, prepared by Commerce and the Office of the U.S. Trade Representative, stated that businessmen are not optimistic that the review procedure will prove very useful because:

--The Justice response will ordinarily come after the business decision must be made.

--Foreign agents will often be reluctant to give the information needed by Justice to evaluate the proposed transaction.

--Confidential information in letters might be disclosed.

--The mere fact that they have sought guidance will become known and cause adverse publicity.

The report also pointed out that business believes the precedential value of the review letters is limited because Justice's statement of enforcement intentions will apply only to the particular transactions under review. The report further stated that it will take a number of years before a sufficiently broad range of issues will have been addressed under the procedure to provide useful guidance.

Another criticism of the program has been the lack of SEC participation. Both the National Governors Association and the White House task force studying export disincentives expressed concern that the review procedure would not bind SEC from taking enforcement action. As previously noted, SEC and Justice share responsibilities for enforcing compliance with the antibribery provisions by SEC-registered companies. SEC, which is an independent regulatory agency, had declined Justice's invitation to join in the review. Therefore, business has been concerned that SEC could initiate an investigation and file a civil action against a registrant even though that company had obtained a review letter stating that Justice had no intention of seeking enforcement action.

The Director of SEC's Enforcement Division strongly opposed offering guidelines to the business community and has been quoted as saying that

--Unify enforcement of the antibribery provisions in Justice, leaving jurisdiction over the accounting provisions with SEC.

--Clarify the ambiguities in the law.

--Require Justice to issue guidelines using hypothetical cases, where appropriate, that could clearly and comprehensively guide U.S. firms as to the interpretation which Justice is placing on the act for purposes of enforcement and criminal prosecution. This will be in addition to Justice's current review procedure.

--Provide that convictions for criminal violations may be made only with sufficient proof that the violations were committed with willful intent.

Further information regarding the review procedure should be available soon. President Carter directed the Attorney General and the Secretary of Commerce to review the effectiveness of the procedure after it has been in effect for 1 year. The President further directed them to report by March 1, 1981, on the results of the review and any recommendations that may be necessary to clear up any ambiguities in the act. In that regard, Justice and Commerce requested the public to comment by February 16, 1981, on the effectiveness of the review procedure. Justice and Commerce received only five comments--four of which specifically addressed the review procedure. All four of these comments were critical of the effectiveness of the review procedure. For example, one company commented that "the review procedure is ineffective" and it "probably cannot be made workable."

AN INTERNATIONAL ANTIBRIBERY AGREEMENT IS NEEDED

Compounding the perceived ambiguities in the act's antibribery provisions is the lack of an international antibribery agreement. The President and the Congress both recognized that success in reducing bribery of foreign officials by all businesses, U.S. and non-U.S. alike, is contingent on strong international efforts. Although efforts have been in process for more than 4 years, the United Nations has proved unable to achieve an international antibribery agreement.

Without an effective international ban against bribery, a competitive advantage could be given to non-U.S. firms. No other nation has antibribery prohibitions similar to the act. If foreign businesses are not restricted by similar antibribery provisions, they could continue to make questionable payments to foreign officials. Over 50 percent of our questionnaire respondents believe an international agreement would strengthen American companies' competitive position abroad. As discussed in chapter 2, they reported that, assuming all other conditions

act. Unlike Justice's recently developed review procedures, all documents submitted by issuers and domestic concerns would be exempt from disclosure under the Freedom of Information Act and either returned or destroyed. This would encourage issuers and domestic concerns to submit inquiries without worrying whether the information would be publicly disclosed.

Also, courtesy items, marketing education, or expenses related to the demonstration or explanation of products would not be considered bribes under the bills. The present act does not have these exclusions. Additionally, any payments, which are considered lawful in the foreign country in which they are made, would not be prohibited under the bills.

Further, the bills would express the sense of the Congress that the President should pursue the negotiation of bilateral and multilateral agreements with other nations to establish standards of conduct for international business practices.

These bills address our concern that alternative ways of providing guidance are needed to resolve the ambiguities in the antibribery provisions. Also, we fully support the sponsors' call for the Congress to urge negotiation of an international antibribery agreement.

We believe the problem of dual enforcement of the provisions by Justice and SEC could be addressed by requiring SEC to participate with Justice in any guidance program and to be bound by the guidance provided business. The elimination of SEC's enforcement authority, however, is a matter for the Congress to decide. Whether other countries' laws will be the basis for determining if a foreign payment is lawful is also a matter for the Congress to decide.

CONCLUSIONS

Uncertainty about what constitutes compliance with the antibribery provisions may have caused U.S. businesses to forgo legitimate export opportunities. Companies, particularly those which have reported a decrease in overseas business, have significiant problems interpreting the antibribery provisions. A Justice guidance program has yet to alleviate this uncertainty, and it is doubtful it will in its present format. The program has been criticized by some Government officials as inadequate and has been used only nominally by business.

The act is an expression of congressional policy, and rigorously defined and completely unambiguous requirements may be impractical and could provide a roadmap for corporate bribery. On the other hand, companies, whether registered with SEC or domestic concerns under Department of Justice jurisdiction, should be subject to clear and consistent demands by the Government agencies responsible for enforcing the act.

--the definition of "foreign official,"

--the responsibility of a company for the actions of foreign agents and officials,

--making facilitating payments, and

--corrupt versus noncorrupt payments.

Because of the importance of the act and the questions and concerns about the antibribery provisions, close congressional oversight is needed. We therefore also recommend that the Attorney General and the Chairman of SEC report no later than June 30, 1981, to the Chairmen of the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Energy and Commerce on alternative ways to address the antibribery ambiguities.

AGENCY COMMENTS AND OUR EVALUATION

Both SEC and Justice disagree with our recommendation that they develop alternative ways to address the antibribery provisions. They contend that our statistics suggest that ambiguities in the act are not a significant problem. In addition, Justice believes that until it, along with Commerce, completes its examination of the effectiveness of the Justice Foreign Corrupt Practices Act Review Program, our conclusions are premature. In its reply, the State Department indicated that it supports our recommended option to offer legislative proposals to amend the act to reduce the ambiguities. The Commerce Department, although seemingly supporting our report, did not expressly address our recommendations. Appendicies IV to VII show the agency comments and our detailed evaluation where it is appropriate.

We disagree with SEC's and Justice's contention that ambiguities in the antibribery provisions are not a significant problem. Our review shows that a serious problem exists concerning the clarity of the provisions. A signficiant percentage of our questionnaire respondents, particularly respondents who reported lost overseas business as a result of the act, rated the clarity of these provisions as less than adequate. For example, over 55 percent of the respondents who reported lost business rated the clarity of the "reasons to know" provision as inadequate or very inadequate, and another 18 percent rated the clarity as only marginally adequate. This provision was also severely criticized in the September 1980 report on exports prepared by Commerce and the Office of the U.S. Trade Representative.

We also do not agree with Justice's contention that our conclusions are premature. The Foreign Corrupt Practices Act has been in effect for more than 3 years. Concern over the clarity of the act's antibribery provisions has been expressed during

SURVEY RESULTS

This appendix shows how the 185 corporations that responded to the survey answered each question. The percentage to the right of the question alternatives show the percent or proportion of companies answering the question that chose that particular alternative. In some cases questions were preceded by a filter question that screened out a proportion or percent of the population. The reader is cautioned to account for these filter questions when comparing the results of responses to specific questions back to the statistics cited in the body of the report. Because there are instances where the respondent could choose more than one alternative, the sum of the percentages for each alternative need not necessarily total 100 percent. Also, in questions where the respondent was asked to write in an amount (e.g., the number of years), the average or mean of reported amounts is presented. In matrix-type questions, the percentage of respondents choosing a particular alternative are typed within the appropriate matrix box or row-column space.

4. Which employee groups have been informed of your policies for handling each of the improprieties listed below? *(Check all applicable columns 1-6 or check 7 not applicable for each row.)*

	All supervisors	Certain supervisors	All nonsupervisory employees	Certain nonsupervisory employees	All agents	Certain agents	Not applicable: no policy
	1	2	3	4	5	6	7
1. Questionable or improper foreign payments	77%	23	25	75	53	47	
2. Domestic or foreign bribes	80	20	25	75	52	48	
3. Giving expensive gifts	83	17	27	73	42	58	
4. Using corporate funds for political contributions	81	19	29	71	46	54	
5. Misuse or mismanagement of cash pools or funds	87	22	23	77	33	67	
6. Failing to record financial transactions	76	24	25	75	38	62	
7. Failing to secure proper authorizations for transactions	74	26	25	75	38	62	
8. Failing to assure for the security of all company assets	73	27	22	78	46	54	
9. Failing to assure for the proper utilization of all company assets	74	26	22	78	39	61	
10. Making false entries on company books or records	75	25	23	77	33	67%	

5. What proportion, if any, of those subject to the policies listed below are required to acknowledge in writing that they have received and read, or will comply with the policies: *(Check one.)*

	Few if any	Some	About half	Most	All or almost all
	1	2	3	4	5
1. Questionable or improper foreign payments	11%	26	3	11	49
2. Domestic or foreign bribes	11	27	3	11	48
3. Giving expensive gifts	19	24	3	9	46
4. Using corporate funds for political contributions	15	24	3	10	49
5. Misuse or mismanagement of cash pools or funds	11	26	2	11	50
6. Failing to record financial transactions	14	27	2	10	47
7. Failing to secure proper authorizations for transactions	20	26	2	9	43
8. Failing to assure for the security of all company assets	16	29	3	9	43
9. Failing to assure for the proper utilization of all company assets	15	27	3	8	47
10. Making false entries on company books or records	13	26	3	11	48%

12. Again, if yes to 10, and if applicable, what was the nature of these changes (e.g., new policies were issued to cover a type of violation that had not been previously addressed, more people were required to acknowledge in writing, stricter codes of discipline were applied, etc.)? *(Check all that apply.)*

1. ☐ Policies were rewritten to be more specific or to expand scope 84.2%
2. ☐ Policies were issued to cover type(s) of violation that had not been previously addressed 47.5
3. ☐ More people were informed 67.3
4. ☐ People were informed more often 34.7
5. ☐ People were required to acknowledge in writing more often 55.4
6. ☐ Procedures for communicating policies were made more formal 60.4
7. ☐ More attention was given to the procedures for informing people 54.5
8. ☐ More effort was put into the development and use of visual aids, presentations, and media material for communicating policies 16.8
9. ☐ More severe disciplinary measures were adopted for code violations 13.9
10. ☐ Other *(specify)*__________ 9.9

13. Were your corporate policies or codes of conduct covering questionable practices, improprieties, etc., in the use of corporate funds and transaction reporting changed during the 4-year period prior to the enactment of the Foreign Corrupt Practices Act in December 1977?

1. ☐ Yes **(continue)** 50.9
2. ☐ No **(go to 16)** 49.1%

14. If yes to 13, what policy areas were changed and how extensive were these changes? *(Check the columns showing the area and the extent of the changes.)*

	Minor changes were made (1)	Important changes were made (2)
1. Questionable or improper foreign payments	49.3%	50.7
2. Domestic or foreign bribes	45.2	54.8
3. Giving expensive gifts	60.9	39.1
4. Using corporate funds for political contributions	50.9	49.1
5. Misuse or mismanagement of cash pools or funds	63.2	36.8
6. Failing to record financial transactions	67.5	32.5
7. Failing to secure proper authorizations for transactions	79.3	20.7
8. Failing to assure for the security of all company assets	80.8	19.2
9. Failing to assure for the proper utilization of all company assets	81.8	18.2
10. Making false entries on company books or records	68.3	31.7%

19. Consider those payment transactions made to agents who are foreign during your last fiscal year. About what proportion, if any, of these payments were reviewed by internal audit? (*Check one.*)

1.	A small portion, if any (less than about 15%)	49.3%
2.	A quarter (from about 15% to 35%)	13.5
3.	A half (from about 36% to 65%)	7.4
4	Three-fourths (from about 66% to 85%)	4.7
5.	All or almost all (more than 85%)	25.0

20 To what echelon of responsibility does the head of internal audit directly report? (*Check one or more.*)

1.	The comptroller	30.7
2	The chief financial officer (if other than the comptroller)	42.5
3	The president	11.2
4.	The Board of Directors or its Audit Committee	43.6
5	Other (*specify*)____________	19.6

21. Does the Board of Directors have an audit committee?

1	Yes **(continue)**	97.3%
2	No **(go to 23)**	2.7

22. If yes to 21, how many people are on the audit committee and how many are independent of management?

1 Number on audit committee mean 3.7

2. Number independent of management mean 3.6

23. Were your audit and control functions, staffing and/or procedures reviewed or compared with the provisions and requirements of the Foreign Corrupt Practices Act of 1977?

1	Yes **(continue)**	95.7
2	No **(go to 26)**	4.3

24. If yes, did this review cause any revisions or increases in the activities of your audit and control functions, staffing, procedures, or documentation?

1.	Yes **(continue)**	80.7
2	No **(go to 26)**	19.3

25 Again, as a result of this review, to what extent, if at all, have you made the following changes? (*Check one column for each row.*)

	To little or no extent	To some extent	To a moderate extent	To a great extent	To a very great extent	No basis for judgment
	1	2	3	4	5	6
1. More clearly specified the division and echelon responsible for maintaining an adequate accounting and control system	32.9%	22.9	22.1	13.6	8.6	
2. Increased the number of special review audits or investigations	34.8	23.2	26.1	11.6	4.3	
3. Increased the routine testing of accounting or control systems	20.9	26.6	28.8	18.7	5.0	
4. Increased the amount of internal accounting control documentation	3.5	16.9	29.6	23.2	26.8	
5. Increased the auditing of payments to foreign agents	48.7	25.6	11.1	11.1	3.4	
6. Increased the size of the internal audit staff	40.3	19.4	21.6	12.2	6.5	
7. Increased the responsibility of the internal audit staff	26.1	26.1	26.1	15.9	5.8	
8. Increased the training of the internal audit staff	30.7	33.6	24.1	7.3	4.4	
9. Increased the independence from management of the internal audit staff	58.3	12.9	14.4	9.4	5.0	
10. Increased the independence from management of the Board of Directors or its Audit Committee	78.0	6.8	9.1	5.3	0.8	
11. Increased the number of Audit Committee members who are independent of management	91.0	3.8	1.5	1.5	2.3	
12. Increased the size of the Audit Committee	91.7	4.5	1.5	0.8	1.5%	

29 If yes to 28, to what extent, if at all, did this nonbenefit cost burden increase the costs of your accounting and auditing activities? (*Check one.*)

1. ☐ To little or no extent (about 10% or less) 27.3%
2. ☐ To some extent (from about 11% to 35%) 49.5
3. ☐ To a moderate extent (from about 36% to 65%) 13.4
4. ☐ To a great extent (from about 66% to 90%) 4.1
5. ☐ To a very great extent (more than 90%) 5.2

30. What effect, if any, has the Foreign Corrupt Practices Act had on the ease with which your company is able to recruit board members? (*Check one.*)

1. ☐ Easier to recruit board members
2. ☐ No effect on recruiting board members 91.8
3. ☐ More difficult to recruit board members 8.2

31. What effect, if any, has the Foreign Corrupt Practices Act had on the cost of your directors' and officers' liability insurance? (*Check one.*)

1. ☐ Decreased the cost 0.6
2. ☐ No effect on the cost 84.4
3. ☐ Increased the cost 15.0

32. What effect, if any, has the Foreign Corrupt Practices Act had on the amount of time your directors spend on company affairs? (*Check one.*)

1. ☐ Substantial decrease in time 0.6
2. ☐ Slight or minor decrease in time 1.7
3. ☐ No change in time 31.7
4. ☐ Slight or minor increase in time 57.2
5. ☐ Substantial increase in time 8.9

IV. YOUR OPINIONS ABOUT THE IMPACT OF THE FOREIGN CORRUPT PRACTICES ACT

33. In your opinion, to what extent, if at all, has the Foreign Corrupt Practices Act affected your total overseas business? (*Check one.*)

1. ☐ A great increase in business
2. ☐ A moderate increase in business
3. ☐ Somewhat of an increase in business
4. ☐ Little or no effect on business 67.7
5. ☐ Somewhat of a decrease in business 19.6
6. ☐ A moderate decrease in business 12.0
7. ☐ A great decrease in business 0.6

34. To what extent, if at all, has the Act discouraged foreign buyers or agents from doing business with your firm? (*Check one.*)

1. ☐ To little or no extent 72.4
2. ☐ To some extent 14.7
3. ☐ To a moderate extent 10.6
4. ☐ To a substantial or great extent 2.4
5. ☐ To a very great extent

35. Has the Act limited the number of countries in which your company does business?

1. ☐ Yes 11.4
2. ☐ No 88.6

36. If yes, please indicate the number of countries in which you no longer do business.

1. ☐ 1 20.0
2. ☐ 2 – 3 55.0
3. ☐ 4 – 5 25.0%
4. ☐ 6 or more

43. To what extent, if at all, do you believe an international agreement against bribery would strengthen American companies' competitive position abroad? (*Check one.*)

1. ☐	To little or no extent	38.4%
2. ☐	To some extent	33.3
3. ☐	To a moderate extent	17.0
4. ☐	To a great extent	10.1
5. ☐	To a very great extent	1.3
6 ☐	No opinion	

45. Do you feel that the Foreign Corrupt Practices Act has been effective in reducing questionable foreign payments by American companies? (*Check one.*)

1 ☐	Yes	21.8%
2. ☐	Probably yes	54.7
3 ☐	Undecided	18.3
4 ☐	Probably no	3.9
5 ☐	No	1.1

44. If to little or no extent, please explain why you think an international agreement would not be effective in strengthening American companies' competitive position abroad? ____________________

ADDITIONAL COMMENT

46 If you have additional information which you feel is relevant to any of the preceding questions, or if you have comments about questions we should have asked but did not, please feel free to express your views below.

OPTIONAL INFORMATION

47. We would like to determine whether size is an important consideration in assessing impact of the Foreign Corrupt Practices Act. If you care to, would you mind giving us a general idea of your company's 1978 sales volume? (*Check one.*)

1. ☐	$1 billion or more	27.0
2. ☐	$400-$999 million	29.3
3. ☐	$250-$399 million	20.7%
4. ☐	$150-$249 million	16.7
5. ☐	Below $150 million	6.3%

Thank you

against participation. The sample screen was necessary because of the changes that had occurred between the time the universe was developed and the execution of the study and because of the great difficulty in sorting out these types of cases from the universe in advance of the sampling and data collection operations.

VALIDATING THE QUESTIONNAIRE RESULTS

In the validation study we visited 27 companies. During these visits, we interviewed the company officials and reviewed documentation and records considered necessary to assess the credibility of the respondents' answers on all objective questionnaire questions. On the opinion questions, the respondents were asked to reconsider their initial views and explain inconsistencies. In every case, almost all the corporate questionnaire responses were found to be consistent with the auditors' findings. The validation visits were conducted under a pledge of confidentiality, and all the validation data was recorded as an anonymous response. No company can be identified from the data collected in this study.

Statistical tests indicated almost no difference between the responses of the validation sample and of the sample responding to mailed self-administered questionnaires. The two samples were compared on their responses to 191 items. A statistically significant difference was found in only five of these items, and in each case the actual value of this difference was relatively small. 1/ Also there was no difference between the nonresponse rate of the mail and of the validation samples. Hence the results of the study were based on the pooled responses of both the validation and mail respondents.

CALCULATING THE EFFECTIVE UNIVERSE AND SAMPLE SIZE

The universe was Fortune's 1977 list of the 1,000 largest (by sales volume) U.S. industrials. As previously mentioned, this list contained a small portion of inappropriate cases which,

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1/On question 26, 85 percent of the validation sample and 60 percent of the mail sample increased their audit and control functions during the 4 year period before the enactment of the Foreign Corrupt Practices Act in December 1977. For question 27, the mail sample respondents had a slightly greater tendency to increase the number of special audits, as well as the audit payments to foreign agents, than the respondents in the validation sample. Similarly, for question 37, the mail respondents had a little more trouble than the validation respondents with the wording of the act's provisions on contributions to political parties. However, the converse was true on the issue of materiality.

QUESTIONNAIRE RESPONDENTS BY INDUSTRY CLASSIFICATION

Industry category	Number of respondents
Food	22
Metal manufacturing	21
Electronics--household appliances	14
Machinery--farm, office, mining, and industrial	11
Metal products	11
Chemicals	11
Work products--furniture, paper, fiber, and lumber	10
Measuring, scientific, and photographic equipment	8
Metalworking and special industry machinery	8
Petroleum refining	8
Motor vehicle transportation	7
Office equipment, including computers	7
Publishing and printing	7
Glass, concrete, abrasives, and gypsum	6
Rubber, plastics, and leather products	6
Textile and vinyl flooring	6
Aerospace	4
Mining and crude oil production	4
Musical instruments, toys, and sporting goods	4
Shipbuilding and railroad transportation equipment	3
Wholesale trade--farm products and raw materials	2
Apparel	1
Laundries and drycleaning plants	1
Real estate--subdividers, developers, and builders	1
Tobacco	1
Wholesale trade--miscellaneous	1
	a/185

a/These figures do not include respondents from the additional 25 construction and 20 aircraft companies which we separately sampled. (See p. 15.)

the enactment of the FCPA, to make important changes in their audit and internal accounting control functions, and in their codes of conduct, despite the fact that a large number had already made changes in these areas in the four years prior to enactment of the statute. The data suggest that in the absence of the statute serious deficiencies would have remained uncorrected. The data also indicate that the bribery prohibitions of the Act have been effective in reducing corporate bribery of foreign officials and that these results have been achieved without serious losses of overseas business.

The draft report correctly points out that the FCPA has been the subject of controversy in the three years since the statute was enacted. It also notes allegations of some persons that key terms of the Act are ambiguous and confusing and recommends consideration of possible steps that could be taken to alleviate the concerns that have been expressed. In this context, the Commission recognizes that implementation and interpretation of the FCPA involves the consideration of several difficult issues. In addition, although the Commission has a number of reservations about the discussion set forth in the draft report, it welcomes the completion of the GAO's draft report because it has provided the occasion for the Commission to address important issues concerning the FCPA, and assisted the Commission in clarifying its own views, in light of the survey data.

Although our comments are rather lengthy, we believe that the GAO will find our views constructive and helpful. Our comments seek to put the Act and its legislative history in perspective, to explain why many of the criticisms of the Act are either misplaced or exaggerated and to emphasize the importance of going beyond the assertions of some persons that the Act is confusing and ambiguous to an analysis of competing policy considerations and an effort to reconcile these competing considerations in a manner that is consistent with the purposes of the Act. In addition, our comments concerning the draft report eludicate the Commission's position with respect to important points in a manner that we hope will lead to a greater understanding of the impact and meaning of the Act. In this context, we believe it would be useful for the GAO to include a more detailed assessment of the merits and shortcomings of the criticisms that have been leveled at the Act in order to assist the Congress in evaluating the important issues that exist concerning the FCPA.

Our comments are set forth below with respect to each of the four chapters in the GAO's draft report. Please note, however, that any changes made in response to our comments may also have to be made at appropriate places in other portions of the draft, as well as in the cover summary and the digest.

Chapter 1: PERSPECTIVE

A. Reasons for Enactment of the Bribery Prohibitions of the FCPA

We can well understand the desire for relative brevity in the report, and we are of course aware of the length of this response. But a more de-

B. Reasons for Enactment of the Accounting Provisions

In the context of the reasons for enactment of the accounting provisions, the draft merely indicates that the Commission "found that millions of dollars were inaccurately recorded in corporate books and records." It does not adequately reflect why the Commission and the Congress thought it was important to enact the accounting provisions.

It should be noted at the outset that the accounting provisions were intended largely as a self-regulatory measure. The Commission's Report on Questionable and Illegal Corporate Payments and Practices, which recommended the enactment of the accounting provisions to the Congress, reflects that the primary thrust of the Commission's actions in the area of questionable payments was "to restore the efficacy of the system of corporate accountability and to encourage the boards of directors to exercise their authority to deal with the issue." 6/

In detailing the Commission's findings with respect to the corporate payments cases that had come to its attention during the previous three years, the Commission's Report concluded:

> 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 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. 7/

The "most devastating disclosure" resulting from the Commission's inquiry was the extent to which some companies had falsified their books and records, in many cases with the knowledge of top management. 8/ The Commission's Report also found a number of other disturbing practices associated with the making of questionable or illegal payments, including the "accumulation of funds outside the normal channels of financial accountability, placed at the discretion of one or a very small number of corporate executives not required to account for expenditures from the fund," the use of "non-functional subsidiaries and secret bank accounts" and the use of various methods of "laundering" or otherwise disguising the source

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6/ Senate Committee on Banking, Housing and Urban Affairs, Report of the Securities and Exchange Commission on Questionable and Illegal Corporate Payments and Practices, 95th Cong., 1st Sess. (1976) (hereinafter referred to as "the Commission's Report") at b.

7/ Id. at a (emphasis added).

8/ Id. at 58 and a.

more effective system of corporate accountability, rather than the sole purpose that those provisions were intended to achieve. Statements (see page 2 of the draft report) to the effect that accounting provisions are "far-reaching," much broader" than the title of the FCPA suggests, and neither "limited to companies doing business abroad, nor * * * restricted to corrupt payments" appear to overlook the concern for improving corporate accountability.

Without the perspective provided by the analysis set forth in the Commission's report and in the legislative history of the FCPA, a reader unfamiliar with those sources might draw the erroneous conclusion that perhaps the Congress failed to understand the implications of what it was doing when it adopted provisions prescribing "internal accounting control objectives and recordkeeping requirements that go beyond corrupt foreign payments" (id.) Nor would such a reader have a sufficient basis for understanding why the statute was enacted and the goals that it is intended to achieve.

(GAO COMMENTS: Although brief in comparison to SEC's lengthy discussion of the act's legislative history and congressional intent, chapter 1 of our report coupled with information on pages 13, 14 and 20, provide report readers the necessary overview to understand the issues discussed in the report.)

C. Undue Emphasis Upon Potential Criminal Liability

Chapter I also evidences a preoccuption with the fact that a violation of the FCPA could, in an appropriate case, result in a criminal prosecution. For example, the draft report states (page 3) that criminal penalties for violation of the accounting provisions would result in "a fine of up to $10,000 and imprisonment up to 5 years" (emphasis added). The report then adds (p. 3) that, "[d]epending on the circumstances, a violation could also result in a SEC civil enforcement action" seeking equitable relief (emphasis added). This suggests that criminal prosecution will be the principal method of enforcement of the accounting provisions when, in fact, it is the civil injunctive action that is the principal mode of enforcement. A criminal prosecution would be recommended to the Justice Department for violation of the accounting provisions only in the most serious and egregious cases. In addition, even if a prosecution should be commenced by the Department, the question of penalties would depend upon the outcome of a trial (if a "not guilty" plea is entered) and the determination by a federal district judge as to what penalty is appropriate, after the trial, and after a finding of a "willful" violation.

The draft report makes no mention of the fact that the Commission has brought six injunctive actions to enforce the accounting provisions in the three years since the FCPA was enacted. In contrast, no criminal cases have been recommended to the Justice Department to enforce those provisions. Nor does the draft report describe the circumstances that caused the Commission to seek equitable relief in the courts. In each case, the violations were of a serious nature and we are not aware of any criticism that those actions were in any way inappropriate

"[W]e would expect that the courts will issue injunctions only when there is a reasonable likelihood that the misconduct would be repeated. In the context of the accounting provisions, that showing is not likely to be possible when the conduct in question is inadvertent."

In the context of civil injunctive actions, but not criminal prosecutions, Chairman Williams also declared, as a statement of the Commission's policy, that "[i]f a violation was committed by a low level employee, without the knowledge of top management, with an adequate system of internal control, and with appropriate corrective action taken by the issuer, we do not believe that any action against the company would be called for." Like inadvertent conduct, such unauthorized violations by low-level employees would not generally support a showing that the issuer _qua_ issuer will repeat the conduct in the future. An injunction against the issuer would therefore be inappropriate.

(GAO COMMENTS: We do not believe that a "policy statement" of a regulatory agency, such as SEC, that can be readily changed by future Commissioners, is sufficient guidance. The development of adequate records and internal controls requires that business be provided with consistent direction by SEC. Such guidance should be formalized and included in SEC's regulations. We do believe, however, that the SEC policy statement, delivered by Chairman Williams in a January 13, 1981, speech--about 30 days after SEC received our draft report--clearly indicates that SEC can be more specific in telling business how to comply with the act's accounting provisions. This policy statement is discussed on page 23 of our report.)

The draft report also gives undue emphasis to potential criminal liability under the bribery provisions. It notes that the "potential penalties for violating the antibribery provisions are severe" and further notes that, in addition to the penalties described above in the context of the accounting provisions, the FCPA provides that "SEC registrants and domestic concerns * * * can be fined up to 1 million." The draft report fails to mention that the Commission has commenced only one injunctive action to enforce the bribery prohibitions in the three years since the statute was enacted. In addition, the Justice Department has brought one civil injunctive action, and one action that had both civil and criminal aspects, to enforce the bribery prohibitions. 15/ Thus, contrary to the impression suggested by the draft report, a criminal prosecution does not automatically result whenever the Commission or the Justice Department discovers a violation of the bribery prohibitions.

15/ _See_ Securities Exchange Act Release No. 17099 (Aug. 28, 1980); 45 Fed. Reg. 59001 (Sept. 5, 1980).

13, 1981, speech when he stated that "the anxieties created by the Foreign Corrupt Practices Act--among men and women of utmost good faith--have been, in my experience, without equal."

Also, concerning the criticisms that a materiality standard should be incorporated in the accounting provisions, we concluded--and our conclusion was supported by SEC--that such a standard by itself is inappropriate given the act's intent. SEC, in its comments, states that our position was an aspect of the act that many critics have overlooked. SEC further stated that our analysis of why such a standard is inappropriate is the kind of useful analysis and balance that is needed by the Congress.)

Moreover, most of these criticisms are anonymous. Although we recognize that some persons may be reluctant to speak about corporate bribery in a public manner as a result of the "sensitivity" of the subject (see pages 16 and 19 of the draft report), this does not alter the fact that anonymous comments are neither as credible nor as probative as the empirical data the GAO received in response to its questionnaire. For example, Representative Bob Eckhardt, one of the principal sponsors of the FCPA, emphasized the importance of having critics of the FCPA speak with candor and a willingness to make their position public and open, so that the Congress can make its own evaluation of the facts. 16/ During a hearing before the Subcommittee on Oversight and Investigations of the House Committee on Interstate and Foreign Commerce, the Chairman of the White House Task Force on Export Disincentives indicated that that group had received certain information about the impact of the FCPA from many sources, including businesses which "insisted that their company name and the details of the transaction not be revealed." 17/ Congressman Eckhardt responded:

> "I must say that ultimately the persuasiveness of the information will be reflected upon by the failure to be able to identify the source of the information * * *. That sort of thing would not be given much weight by anybody probing a factual question." 18/

16/ Hearing before the Subcommittee on Oversight and Investigations of the House Committee on Interstate and Foreign Commerce, Serial No. 96-56, 96th Cong., 1st Sess. (1979) at 21.

17/ Id. at 23.

18/ Id. at 24.

Similar findings were made with respect to the effect that the FCPA has had in the area of corporate codes of conduct. Nearly all of the respondents -- 98% -- reviewed their codes of conduct or compared them with the requirements of the FCPA. In addition, 63.4% of the respondents made changes or revisions as a result of that review. These figures seem particularly noteworthy in view of the survey data reflecting that 50% of the respondents had already made changes in their codes of conduct in the four-year period prior to enactment of the FCPA, and 25% did not find further changes to be necessary after the law became effective. Moreover, the changes that were made since the enactment of the FCPA were characterized by the respondents as "important" rather than "minor" in the following areas: questionable or improper foreign payments (40.5%); misuse or mismanagement of cash pools or funds (45.2%); failure to record transactions (53.6%); failure to secure proper authorization for transactions (50%); failure to assure the security of company assets (47.1%); failure to assure proper utilization of company assets (46.3%); and the making of false entries on company books and records (47.5%). The fact that such large percentages of the responding companies found it necessary or desirable to make "important" changes in these areas provides strong evidence that the accounting provisions have caused issuers to address possible serious deficiencies in their systems of internal accounting controls.

On the other hand, despite the "reasonable assurances" limitation in the internal accounting controls requirement, which is designed to make clear that the costs of internal accounting control are not required to exceed the benefits thereof, the survey reflects that slightly more than half of the respondents (56.4%) believed the costs of compliance with the accounting provisions had exceeded the resulting benefits. The remainder (43.6%), stated that the costs were not excessive. It should be noted, however, that of the respondents indicating that the costs of compliance did exceed the benefits, 27.3% (15.4% of the universe of respondents) viewed the perceived excess costs as marginal (in the range of 10% or less). Thus, 59% of the respondents reported that there were either no excessive costs or an excess of 10% or less. Approximately 28% of the respondents estimated excess costs at between 11% and 35%, which the GAO questionnaire characterized as less than a "moderate" amount. In summary, approximately 87% viewed the excess costs as less than a "moderate" amount (excess costs of 36 to 65%), while only 5% stated that excess costs were "great" or "very great" (excess of more than 66%).

The draft report notes that "[c]ost-benefit analysis * * * [implicit in the "reasonable assurances" limitation] is not an exact science" and suggests that the perception of excessive costs "may be due to the subjectivity inherent in determining what constitutes compliance with the Act and to the limitations in performing a cost-benefit analysis." The draft report then refers to a recent study prepared by the Financial Executives Research Foundation, which found that an objective measure can rarely be made of costs and benefits. As a result, the draft concludes that some corporate officials may have expended more on internal accounting controls than they would normally have spent for business purposes in order to minimize the risk of noncompliance.

respect to the deficiencies that they discovered. In addition, it should be noted that improved systems of internal accounting controls should serve to reduce the costs of the annual audit of the financial statements of issuers, because the auditors will be able to place greater reliance on such systems than they did prior to enactment of the FCPA.

(GAO COMMENTS: SEC officials advised us that they did not have any hard data supporting their assertion that a large portion of the costs incurred may be in the nature of one-time, start-up costs. Systems of internal accounting control are dynamic in nature and are constantly changing to adapt to the business environment. The costs of updating, maintaining, and monitoring systems of internal control, which can be quite high, are continuing, not one-time expenses.)

Moreover, it should be apparent, after three years of experience, that the Commission will not, as some have feared, use the accounting provisions as a basis for taking enforcement action against public companies, no matter how trivial or insignificant an infraction might be. As noted above, only six injunctive actions have been filed, and one administrative proceeding instituted, in the three years since the FCPA was enacted.

Under these circumstances, the fact that only two out of five respondents reported more than a marginal excess of costs, is a strong indication that the "reasonable assurances" standard is not as ambiguous and confusing as some have suggested. In fact, an argument could be made that the additional experience has either eliminated, or will largely eliminate, the problem experienced by those respondents who did report excess costs of more than a marginal amount at some point in the last three years.

Even if there may be some excess costs on the basis of the calculation performed by an issuer for its own purposes, it should be recognized that the "benefits" to the nation in the form of more reliable disclosure to investors, improved accountability, greater confidence in the capital market system and the deterrence of bribery and other improper conduct are important considerations. To the extent "excess costs" may be of a marginal nature, these "benefits" might be viewed by the Congress as justifying some degree of "excess costs".

(GAO COMMENTS: We do not believe that SEC's prior enforcement record will completely alleviate business fears about how the accounting provisions might be applied in the future. For example, an official of the American Institute of Certified Public Accountants, commenting on Chairman Williams' January 13, 1981, speech which emphasized SEC's enforcement policy, stated that it sounds as if it is the benevolence of the enforcers that is being offered. He further commented that any institution that depends on the benevolence of those in charge will always have cause to worry, and he called for more explicit guidelines from SEC.

that between 248 and 396 companies in the Fortune 1000 could have lost business. In addition, SEC fails to mention the results of our surveys of leading companies in the aircraft and construction industries. In that survey more than half of the respondents indicated that the act has caused them to lose business. This finding is significant and deserves close attention by the Congress.)

These figures seem particularly significant in view of the fact that the GAO questionnaire merely asked for "your opinion, to what extent, if at all" the FCPA has "affected your total overseas business," an approach that might be expected to result in an exaggeration of the amount of business lost. In short, the data appears to provide a strong confirmation of the view, expressed by proponents of the FCPA prior to its enactment, that corporate bribery is generally unnecessary in order to obtain, retain or direct business to U.S. companies.

Another finding that appears to be particularly significant concerns the clarity of the bribery prohibitions. These provisions have been criticized in many quarters as ambiguous and confusing, and these criticisms are repeated in the draft report despite survey data that suggests an opposite conclusion. For example, a total of 79.5% of the respondents indicated that the clarity of the bribery prohibitions was either "adequate" or "more than adequate." In contrast, only 8.8% expressed the view that the clarity of the bribery prohibitions was either "inadequate" or "very inadequate." 23/

23/ The remainder, about 11.7%, characterized the bribery prohibitions as of "marginal clarity."

Other responses to the same question reflect a greater degree of concern about certain aspects of the bribery prohibitions, but these also represent a minority view. Only 19.3% described the provision concerning facilitating payments as "inadequate" or "very inadequate," while 58.5% reported that the same provisions were "adequate" or "more than adequate." Similarly, only 23.5% stated that the clarity of the Act concerning questionable payments by subsidiaries was either "inadequate" or "very inadequate," but 57.8% stated that the provisions were either "adequate" or "more than adequate." The greatest difficulty was evident with respect to a company's responsibility for the actions of foreign agents, but even in this area, only 36.9% believed the bribery provisions were "inadequate" or "very inadequate," while 45.3% indicated that the same provisions were "adequate" or "more than adequate."

standard, there are no standards to guide companies in complying with the Act and no limitations on potential liability, and, thus (c) overlook the fact that the "in reasonable detail" and "reasonable assurances" standards, although new and unfamiliar, serve both to provide guidance as to what must be done to comply with the Act and to limit liability.

In addition to its failure to present analysis of which criticisms have merit and which do not, the draft does not present analysis of the meaning and function of the "in reasonable detail" and "reasonable assurances" standards so that the Congress will have a basis for understanding these terms and for assessing the degree of merit which criticisms of those standards may have and whether proposed changes, such as the inclusion of a "materiality" standard, would be consistent with the purposes of the Act. The draft report also fails to delve below the surface of the criticisms and point out that the underlying concern is not really "what constitutes compliance," as the draft report suggests, but rather an understandable desire, with which we have some sympathy, for assurances that entities and individuals will not be held liable for inadvertent or insignificant infractions, or merely for proceeding in accordance with a judgment within reason with which the Commission may subsequently differ.

(GAO COMMENTS: We disagree with SEC's contention that we criticize the accounting provisions without analyzing their merits. Our analysis and conclusions regarding the accounting provisions in chapter 3 point out just the opposite. We also disagree with SEC's assertion that we do not present an analysis of the terms "in reasonable detail" and "reasonable assurance." Also SEC's distinction between concern over compliance and business desires to avoid legal liability is not valid. The two factors are related—concern over compliance resulted in excess costs being incurred to avoid legal liability. Certainly, given the potential penalties facing violators, liability is an important consideration. However, companies are also concerned about what they perceive as excessive costs incurred to comply with what they perceive as unclear and unreasonable provisions. Recognizing this relationship and the inherent subjectivity and clarity problems surrounding the accounting provisions, our final report recommends that SEC provide guidance to the business community on the factors and criteria that will be taken into account in assessing reasonableness. This guidance could take the form of hypothetical situations or actual examples, or could specify actions that would be indicative of reasonable action to comply with the accounting provisions. In addition, we are also recommending that the Congress remove the criminal penalties associated with the act's accounting provisions.)

We recognize that there are certain problems in interpreting the FCPA. These problems require careful and judicious consideration. The GAO's report will probably play a key role in the deliberations of the Congress concerning the FCPA. We are concerned, however, that frequent repetition of

APPENDIX IV

It appears that many critics of the accounting provisions erroneously view this situation as an anomaly and fail to understand that such application of general standards of law to factual situations is not unusual in the law. In addition, such persons tend to overlook an important distinction. To the extent that they are concerned about potential liability based upon such an after-the-fact assessment of all relevant circumstances, the source of the lack of certainty they perceive is not necessarily in the language of the accounting provisions; rather it lies in the fundamental fact — which is not limited to the FCPA — that general standards of law must be applied to particular sets of facts and circumstances. As a result, there will always be a degree of uncertainty as to potential liability in this area, just as there is in other areas of the law.

The question of "what constitutes compliance" is usually asked with respect to rather narrow and technical provisions which require specific actions to be performed. For example, if a statute requires a company to file an annual report no later than April 15, compliance is effected by filing the report on or before that date. In contrast, "what constitutes compliance" with the internal accounting controls requirement will necessarily depend on an evaluation of all of the facts and circumstances relevant to each reporting company. As the Senate Report states with respect to the internal accounting controls requirement:

> "The size of the business, diversity of operations, degree of centralization of financial and operating management, amount of contact by top management with day-to-day operations, and numerous other circumstances are factors which management must consider in establishing and maintaining an internal accounting controls system." 26/

Although the Commission is sensitive to the concerns of members of the business community who must implement the law, and agrees that there should be workable standards to guide them in their efforts, it is impossible, under these circumstances, for the Commission to satisfy the desire of some for "precise" and "definite" guidance (see pages 32-33). The question of "what constitutes compliance" can only be answered with respect to each individual company subject to the Act. From this perspective, it would clearly be impractical to tell each issuer "what constitutes compliance."

(GAO COMMENTS: Our report does not call for SEC to individually tell each issuer how to comply with the act. We also did not say that guidance must cover "every possible action." The SEC Chairman's January 13, 1981, speech on SEC's enforcement policy is an example of the type of guidance necessary and is a step in the right direction. However, broadly telling business how the current SEC Commissioners will enforce the act is not enough to guide compliance efforts. Fully recognizing that the degree of specificity will be a subjective decision, the recommendations in our final report have been clarified to call for SEC to provide additional guidance coupled with the removal of criminal penalties.)

26/ S. Rep. No. 95-114, supra at 8.

integrity of corporate controls rests on management and the board of directors." 28/ He added that the accounting provisions, in large measure, recite "a business truism":

> "Obviously, it would be impossible to conduct an enterprise of any size without keeping records — accurate records — and without making provisions to ensure that assets are not misappropriated and that the venture operates in accordance with management's instructions rather than each employee's individual whims." 29/

He placed the accounting provisions in perspective, noting that they require "business ventures funded by the investing public" to install recordkeeping and control procedures which would appear necessary "as a matter of effective management * * *." 30/

As discussed more fully below with respect to the "reasonable assurances" standard, the statute now provides corporate officials with broad discretion to decide how their companies will comply with the Act and measures the exercise of that discretion with reference to what a reasonable and prudent person would do under the same or similar circumstances. But it is this very fact that makes it impossible for the Commission to answer the question of "what constitutes compliance" in precise and detailed terms. And the alternative is to take those decisions away from corporate officials through Commission prescriptions of how each company should conduct its internal affairs — an approach that we believe is unwise, unworkable and inconsistent with the purposes of the Act.

C. The "in reasonable detail" and "reasonable assurances" standards

Although the draft report emphasizes the alleged "confusion and controversy" concerning the accounting provisions, it tends to blur the distinctions between the recordkeeping requirement and the internal accounting controls provision (see pages 22 and 31). If the draft report is to be useful to Congress, or persons who are unfamiliar with the FCPA or the reasons why the accounting provisions were enacted, it is important that the report reflect why the two provisions were enacted in their present form. As presently drafted, the report repeatedly states criticisms that the "in reasonable detail" and "reasonable assurances" standards are confusing and ambiguous, but does not attempt to explain what they are intended to accomplish and why they are different. Nor does the draft point out that the relevant policy considerations are very different in evaluating possible changes with respect to these two provisions.

28/ "Implementation of the Foreign Corrupt Practices Act: An Intersection of Law and Management," an address to the Section of Business, Banking and Corporation Law of the American Bar Association, Dallas, Texas (August 14, 1979).

29/ Id.

30/ Id.

At the time the accounting provisions were being considered in the Congress, some members of the business community contended that a standard of accuracy in recording transactions would require an unrealistic degree of precision. In response to these concerns, the Conference Committee added the "in reasonable detail" qualification to make clear that transactions may be recorded "in conformity with accepted methods of recording economic events * * *." 32/

Accordingly, the general rule is that the transaction must be recorded, as Section 320.38 of S.A.S. I states, "at the amount at which it occurs." It is only if the company or its accountants have an "accepted" basis for employing some method of recording a transaction that permits it to be recorded at an amount other than the precise amount at which it occurred, that there may be a question as to how it should be recorded. 33/ For these reasons, the assertion of one accounting firm that "there are no standards to assist in determining compliance with the accounting provisions" is wholly without foundation, as is the statement that "management's view of how accurate their records need to be may differ significantly from the degree of accuracy the Act may require" (see page 24). In short, if a transaction is effected at a particular amount, the presumption is that it should be recorded at that figure, rather than at a greater or smaller amount.

(GAO COMMENTS: Corporations should, of course, record transactions in the proper amount. However, it must be recognized that accounting transactions are subject to human error when entries are made in the books and records. Also, various accounts, such as bad debt expenses and depreciation, are based on estimates and not on precise amounts. In this regard, Statement on Auditing Standards No. 1--on which the act's accounting provisions are essentially based--allows for errors and estimates by including the use of a materiality standard in assessing the effect of any imperfection in the accounting process. Further, the Congress made it clear in the legislative history of the act that it was not expecting perfect books and records. Instead, it is the lack of clarity that is a concern of business.)

Indeed, the problem with the recordkeeping requirement may be that it is too clear. On its face, the recordkeeping provision appears to make issuers liable for inaccuracies, regardless of whether they are the result of an inadvertent transposition of two numbers, involve an insignificant amount, or could not reasonably have been prevented by the issuer and senior corporate officials. Therefore, criticisms of the recordkeeping provision have tended to take the position that there should be some mimimum threshold amount, below which a transaction could permissibly be recorded at an amount other than that at which it occurs, whether or not there is any basis

32/ H. R. Rep. No. 95-831, 95th Cong., 1st Sess. (1977) at 10.

33/ For example, to the extent a de minimus exemption is recognized and "accepted" in the context of recording economic events, although not in absolute, quantitative terms, it would be permissible under the recordkeeping requirement.

(GAO COMMENTS: SEC's interpretation of our call for additional guidance is overly narrow. Our draft report made it clear that any falsification without regard to the amount or person involved could be a violation of the act's accounting provisions. However, as discussed earlier, to insure that our position is understood, we have clarified our report and revised the language of our recommendations. We are recommending that SEC provide guidance on the factors and criteria that can be used to determine if a business is complying with the reasonableness standard of the act's accounting provisions.)

As we have noted, the real concern in this area is the fear that inadvertent or insignificant infractions will lead to a finding that companies or individuals have violated the recordkeeping requirement and a reluctance to trust that the Commission will exercise its prosecutorial discretion in a reasonable and prudent manner so that such a situation never arises. In our judgment, however, any response to these concerns -- whether legislative or administrative — should begin by maintaining the integrity of the principle that transactions should be accurately recorded in the issuer's system of accounting records. This is a different issue than the question of whether issuers should be held liable for violative conduct — an area that Chairman Williams addressed in his speech before the AICPA (see page 7, supra).

2. The "Reasonable Assurances" Standard

The internal accounting controls provision requires issuers to "devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that * * *" certain statutory objectives are met (emphasis added). This provision, in contrast to the recordkeeping requirement, is addressed primarily to the issuer and its management and to their design and maintenance of a system of internal accounting controls. In this context, corporate managers are responsible for devising and maintaining a system of internal accounting controls that provides reasonable assurances, among other things, that "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"; however, because this provision is addressed to the exercise of management's discretion in devising and maintaining a system that will achieve these objectives and the other objectives set forth in the statute, 36/ as distinguished from the entry of specific transactions in the company's books and records, the Congress employed a different standard than that contained in the recordkeeping requirement — the "reasonable assurances" standard.

36/ The other objectives include the provision of reasonable assurances that "transactions are executed in accordance with management's general or specific authorization"; that "access to assets is permitted only in accordance with * * *" such authorizations; and that "the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences."

and would intrude upon management's prerogative to determine what internal accounting controls may be appropriate for their company, and whether such controls will be cost-effective.

For example, certain changes in a company's code of conduct may be appropriate for some issuers and not for others. Increased routine testing may be appropriate for some issuers, but not be needed by others. It would be unwise to require every issuer to implement such changes in response to a government prescription of "what constitutes compliance"; that would surely entail excess costs for companies that do not need such measures.

(GAO COMMENTS: We agree that government prescription of what each individual company must do to comply would be wholly impractical and would intrude upon management's prerogative to determine what internal accounting controls may be appropriate for their company. We have clarified our final report in calling for SEC to issue guidance to business on the factors or criteria that should be taken into account in assessing reasonableness. The SEC Chairman's January 13, 1981, statements on how SEC will enforce the act is a step in the right direction. However, he did not go far enough in providing the guidance the companies need.)

Under these circumstances, it is the Commission's position, as stated by Chairman Williams in his recent address to the AICPA, that "considerable deference properly should be afforded to the company's reasonable business judgments in this area" (emphasis in original). Chairman Williams added that "the selection and implementation of particular control procedures, so long as they are reasonable under the circumstances, remain management prerogatives and responsibilities." 38/

38/ He pointed out that this standard is not satisfied if a company's leadership, while making nominal gestures with respect to monitoring and evaluating the adequacy of the company's records and internal accounting controls systems, abdicates its responsibilities to foster integrity among those who operate the system:

> "Regardless of how technically sound an issuer's controls are, or how impressive they appear on paper, it is unlikely that control objectives will be met in the absence of a supportive environment. In the last analysis, the key to an adequate 'control environment' is an approach on the part of the board and top management which makes clear what is expected, and that conformity to these expectations will be rewarded while breaches will be punished."

such control procedures would be cost-effective; and (d) the risk of loss is so significant in relation to the costs of the change that it would be unreasonable for a corporate official to refrain from implementing the change involved. If management makes a good faith judgment reasonable under the circumstances that the available control procedures would not be cost-effective, it is not required to adopt the change involved. In addition, even if a potential change is determined to be marginally cost-effective, or the relative costs and benefits of the change cannot be determined with precision, the Congress adopted a standard that accords a measure of discretion to corporate officials as to whether the change should be implemented.

Under these circumstances, there should be no excess costs associated with the devising and maintaining of an internal accounting control system since the Act only requires changes that are, by definition, clearly cost-effective. Moreover, because management has discretion even with respect to potential changes that are cost-effective, there should be no occasion for incurring "excess costs" as a result of a fear of noncompliance merely because management's estimate of relative costs and benefits is approximately equal, or cannot be determined with precision. 39/

(GAO COMMENTS: We disagree with SEC's analysis of the effectiveness of management's cost-benefit determinations to avoid incurring excess costs, and we note that SEC offered no factual support for its view that most cost-benefit judgments will usually fall "clearly" into either the more than or less than category. As pointed out in our report, cost-benefit analysis--a crucial part of the accounting provisions--is not a precise science. Reasonable individuals with good judgment and intentions can differ in their opinions. For example, in its study of internal control, the Financial Executives Research Foundation found that an objective measure of either costs or benefits is rarely feasible. The study noted that with this degree of uncertainty about costs and benefits, managers who are averse to the risk of failing to comply will probably invest more heavily in controls than they normally would for business purposes. In addition, the difficulties of performing a cost-benefit analysis are substantially complicated if companies must not only determine the value of quantitative benefits, such as reducing the exposure to the theft of assets, but also qualitative benefits, such as the reputation of the company.)

39/ One exception to this may be in the area of increased documentation. For example, the draft report reflects the belief of some corporate officials "that the increased documentation was a paper gathering exercise to serve as a defense against SEC inquiries" (page 15). However, this view overlooks the fact that the process of documentation provides a discipline to the exercise of management's discretion in addition to providing a basis for demonstrating that management determinations were reasonable in a Commission inquiry. It may be that the "benefit" inherent in the discipline was overlooked.

Moreover, the question is confusing because it assumes that "materiality" is somehow relevant to the present text of the accounting provisions, despite the fact that the Congress intended that a materiality standard should have no place in the recordkeeping and internal accounting controls requirements. The Congress declined to incorporate a "materiality" limitation in the language of the accounting provisions and instead employed the "in reasonable detail" and "reasonable assurances" standards.

(GAO COMMENTS: SEC failed to consider that the results of question 37 must be considered in conjunction with question 38, which allowed corporations to further comment on certain of their responses. Although approximately 30 percent of the respondents cited the absence of a materiality standard as the reason for a clarification change, this figure excluded those companies who made more general remarks concerning needed changes. Interspersed with both these questions are remarks that compliance with the accounting provisions is unreasonable. To highlight this data, we have made clarifying changes to our report.)

As Chairman Williams noted in his recent address concerning the Act, the Congress "was correct" in rejecting a materiality standard because "[i]nternal accounting controls are not only concerned with misconduct that is material to investors, but also with a great deal of conduct that is not." Chairman Williams also pointed out that

> "materiality, while appropriate as a threshold standard to determine the necessity for disclosure to investors, is totally inadequate as a standard for an internal control system. It is too narrow — and thus too insensitive — an index. For a particular expenditure to be material in the context of a public corporation's financial statements * * * it would need to be, in many instances, in the millions of dollars. Such a threshold, of course, would not be a realistic standard. Procedures designed only to uncover deficiencies in amounts material for financial statement purposes would be useless for internal control purposes. Systems which tolerated omissions or errors of many thousands or even millions of dollars would not represent, by any accepted standard, adequate records and controls. The off-book expenditures, slush funds, and questionable payments that alarmed the public and caused Congress to act, it should be remembered, were in most instances of far lesser magnitude than that which would constitute financial statement materiality."

Under these circumstances, it is not surprising that 77% of the respondents gave an "inadequate" or "very inadequate" answer to the question. The statute was never intended to "explain" what is expected of issuers in terms of the materiality concept.

contain a materiality standard" (emphasis added), it fails to appreciate that there has been a persistent theme among critics that the accounting provisions could not mean what the statute says because there is no materiality standard, and that, as a result, those provisions should be interpreted as if the Congress did include such a standard. On the other hand, although the Congress explicitly rejected the inclusion of a materiality standard in the present law, it is plain that the critics generally agree that the accounting provisions should contain such a standard.

(GAO COMMENTS: As discussed previously, it is an overstatement for SEC to contend that Congress explicitly rejected the concept of a materiality statement. We found no evidence in the legislative history that Congress substantively considered and explicitly rejected a materiality standard.)

We recognize, as noted above, that the recordkeeping requirement, on its face, makes an issuer responsible for any infraction of the standard of accuracy, regardless of whether the amount involved is very low, or whether the infraction resulted from an inadvertent error that the issuer could not have prevented. Similarly, with respect to the internal accounting controls requirement, the draft report reflects that critics are concerned (see page 15) with the fact that cost-benefit analysis "is not a precise science," that "[r]easonable individuals with good judgment and intentions can differ in their opinions" and that a mere "difference in opinion * * * with the SEC" could render a company vulnerable to enforcement action. These expressions of concern must be viewed, however, in light of the fact that it is unlikely that the Commission would take enforcement action under such circumstances, and that none of the Commission's past enforcement actions have involved such circumstances. These concerns should also be considered in light of the Commission's enforcement policies, as stated in Chairman Williams' address to the AICPA.

(GAO COMMENTS: As previously mentioned we do not agree with SEC's assertion that the prevailing accounting requirements must be viewed in light of the current enforcement policies and prior enforcement record. As SEC recognizes, the recordkeeping requirement, on its face, makes an issuer responsible for any infraction of the standard of accuracy regardless of whether the amount involved is very low, or whether the infraction resulted from an inadvertent error that the issuer could not have prevented. Given this severe interpretation of what the provision requires, we question whether it is reasonable to expect companies to rely on SEC's enforcement benevolence.)

There is a good potential in this idea. 42/ There may also be other mitigating standards that could be used to limit liability in a manner consistent with the purposes of the Act. However, by emphasizing what appears to be an arithmetical approach or calling for detailed thresholds, we believe the recommendations of the draft report are unduly narrow. We support the concept that, to the extent it can be demonstrated that there are problems with the terms of the Act that need to be corrected, standards that are both workable and more understandable should be considered.

Finally, to the extent that the GAO draft proposes that the Commission develop new standards "with input from Justice, the corporate community and the accounting profession * * *" (page 35), we agree that the Commission should seek the views of these and all interested parties. However, we believe this should be done within the context of the Commission's normal administrative procedures of soliciting comment from the entire community affected by interpretive views expressed by the agency under the Act.

Chapter 4: ISSUES SURROUNDING THE ANTIBRIBERY PROVISIONS

A. General Comments

The GAO survey reflects that 79.5% of the respondents viewed the clarity of the bribery provisions as either "adequate" or "more than adequate" while only 8.8% expressed the view that the clarity of the provisions was either "inadequate" or "very inadequate". In addition, as we have earlier summarized, more than 76.5% stated that the Act "has" or "probably has" been effective in reducing questionable overseas payments; only 5% asserted that the Act "has not" or "probably has not" been effective.

Moreover, as we have already noted, 87.5% of the companies that engaged in foreign business reported that they had either experienced no decrease in business or only a minor decrease in business as a result of the Act. In contrast, only 12% of the respondents reported a decrease in business that could be characterized as "moderate" and only .6% of the respondents indicated that they had suffered a "great decrease" in business. These findings are remarkable, particularly in view of the fact that the GAO's questionnaire does not distinguish between losses of business that resulted from the clear prohibition of transactions that cannot be effected without bribery and those cases in which it is alleged that businesses have refrained from engaging in overseas transactions that might be legitimate as a result of "uncertainty" as to the meaning of the Act. If, as appears probable, most of the "lost" business involved transactions that are clearly prohibited by the bribery provisions, the remainder representing cases in which possibly legitimate export opportunities were lost as a result of uncertainty must be very small.

42/ We are concerned, however, that the approach recommended in the draft report would permit the falsification of corporate records by persons below the level of "top" management, as long as it was in an amount less than the arithmetical threshold it proposes.

that some criticisms of the Act may be without merit, or exaggerated, and that only a relatively small portion of the business community has experienced either difficulty in understanding the law or a significant loss of business.

(GAO COMMENTS: SEC overlooks the significance of our questionnaire sample, which was based on a methodology allowing projection to the total universe of the 1000 top companies. Our questionnaire showed that between 248 and 396 companies in the top 1000 could have lost business. These results are significant and should not be dismissed as a relatively small portion of the business community. Further, in responding to our draft report the Commerce Department said that in its experience, the impact on smaller companies attempting to enter world markets is even greater.)

In this context, the Commission, in February 1980, requested comments concerning the impact and operation of the bribery prohibitions in order to ascertain the extent to which criticisms of the Act had substance and what actions, if any, the Commission could take in response to these concerns. 43/ Only 14 comments were received despite the four-month comment period. As a result, the Commission did not have enough information properly to evaluate the concerns that were expressed by the commentators. 44/

In analyzing those comments, the Commission pointed out that "the limited response appears inconsistent with published reports that there is widespread concern and uncertainty on the part of public companies and some individuals as to the applicability of the bribery provisions to particular transactions." 45/ The results of the GAO's survey provide additional evidence that these concerns may not be as serious as many critics of the Act have supposed.

In addition, the criticisms of the Act the draft repeats are, for the most part, unidentified and anonymous. This is particularly important in view of the fact that the responses to the GAO questionnaire do not provide data that supports the bulk of the analysis set forth in the draft report. Except for the data noted above, the questionnaire was not designed to elicit such information concerning the impact and implementation of the bribery provisions.

43/ The Commission's request for comments and the public comments received in response to that request are not mentioned in the draft report; the draft merely refers to the Commission's statement, which was made in response to some of the comments, that it will not take enforcement action in any case where an issuer seeks, and receives, a favorable letter from the Department of Justice under the Department's FCPA Review Procedure prior to May 31, 1981.

44/ Securities Exchange Act Release No. 16953 (Feb. 21, 1980); 45 Fed. Reg. 12574 (Feb. 26, 1980).

45/ Securities Exchange Act Release No. 17099, supra.

Again, it is difficult to conclude that this quote, which was picked up by the news media, didn't adversely affect companies' desires to respond to the SEC request. SEC is incorrect in stating that our report does not address its public comment request. (See SEC footnote 43.) Page 17 of our report discusses this point.)

The primary source of the criticisms and analysis reflected in the draft is a report that is improperly characterized (see page 38 and passim) as "a September 1980 report of the President on export promotion functions and potential export disincentives * * *." The GAO draft overlooks the fact that, in submitting that report to the Congress, the President made clear that he was submitting two reports and that the report relied upon by the GAO does not reflect his views:

"I am submitting today my report on these matters along with the full text of the comprehensive review, which was prepared by the Secretary of Commerce and the U.S. Special Trade Representative. Their detailed review, while not a statement of Administration policy, reflects an extensive canvass of the views of our exporting community * * *." My report expresses this administration's policies" (emphasis added).

Thus, the President pointedly disassociated himself from the more voluminous report (hereinafter referred to as the Klutznick/Askew report) that the GAO draft relies upon for the bulk of its background data and analysis. The GAO should at least point out the distinction that the President made in submitting the two reports to the Congress.

(GAO COMMENTS: We have clarified our final report regarding the two reports President Carter submitted to the Congress. It should also be noted that the President referred to the review of the Executive Branch Export Promotion Functions and Potential Export Disincentives as

"* * * the most comprehensive study of its kind ever undertaken by the U.S. government. It contains a considerable amount of information that must be weighted and examined, and will serve as a solid basis for future actions by the Federal government.")

The draft report recognizes (page 48) that "rigorously defined and completely unambiguous requirements may be impractical and could provide a road-map for corporate bribery." However, there is no discussion as to how the desire for greater clarity could be reconciled with the policy of the Congress to eradicate corporate bribery of foreign officials. Moreover, neither the draft report nor the critics whose views are reflected in the draft, have proposed constructive suggestions for alternative formulations, which would both satisfy the desire for greater clarity and yet be practical, consistent with the purposes of the bribery prohibitions and flexible enough to deal with the wide variety of transactions that must be encompassed.

(GAO COMMENTS: We fully understand the nature of the administrative interpretations issued by the SEC in response to public inquiries. Although SEC could decline to respond to questions concerning intent, it could, for example, issue an interpretation on whether a payment being considered is a facilitating payment, or clarify whether a person is considered a foreign official under the act. In an October 1980 statement concerning procedures for providing administrative interpretations, SEC noted that issuing administrative interpretations of a specific law, rule or regulation in the context of a factual situation has been found to be an excellent practice. We agree since such interpretations provide a current statement of the SEC staff's views and are closely followed by many companies, members of the legal profession and other interested parties. Issuing administrative interpretations could resolve some of the confusion over compliance with the act's antibribery provisions.)

C. The GAO's Recommendations

The draft report states a concern (page 47) "that alternative ways of providing guidance are needed to resolve the ambiguities in the Act's antibribery provisions." As noted above, the draft assumes, without an independent analysis by the GAO, that the criticisms expressed by some anonymous members of the business community with respect to the bribery prohibitions accurately reflect the existence of "ambiguities" in those provisions and that those "ambiguities" are so serious that an administrative or legislative response is required. The GAO draft makes this assumption despite the fact that 79.5% of the respondents to its questionnaire rated the clarity of the bribery prohibitions as adequate or more than adequate, while only 8.8% of the respondents (approximately 17 respondents out of 185) rated those provisions as inadequate or very inadequate. These facts and the fact that any business "lost" as a result of uncertainty must be very small are, inexplicably, mentioned nowhere in the draft report.

Nevertheless, the GAO proposes to recommend (page 49) that the Commission and the Justice Department "[o]ffer legislative proposals to reduce the ambiguities." This seems premature in view of the lack of credible and verifiable data as to the need for such legislation. In fact, the questionnaire data points to the conclusion that the alleged ambiguities are not as serious as some had supposed. Moreover, as noted above, neither the GAO draft nor the critics whose criticisms are repeated have made specific suggestions for changes that would both provide greater clarity and be consistent with the purposes that the Congress sought to achieve in adopting the bribery prohibitions.

The draft report also recommends (page 49) that the Commission and the Justice Department "[p]rovide additional guidance to the business community through the use of hypotheticals." Although the draft report notes that "some government agencies and corporate officials" have expressed a desire for "guidance" in the form of hypotheticals, such an approach would be of little value. As noted above, the concerns that have been expressed with respect to the bribery prohibitions result, for the most part, from the

U.S. Department of Justice

JAN 27 1981

GAO note: Page numbers in this appendix refer to the draft report and may not correspond to this final report.

Mr. William J. Anderson
Director
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

This letter is in response to your request to the Attorney General for the comments of the Department of Justice (Department) on your draft report entitled "The Foreign Corrupt Practices Act."

The General Accounting Office (GAO) states that the purpose of their study was "to obtain the basic data we believe the Congress needs to assess the implementation and impact of the Foreign Corrupt Practices Act." The draft report concludes that (1) there is "extensive dissatisfaction" with the clarity of the accounting provisions contained in Section 102 of the Foreign Corrupt Practices Act (Act), (2) the foreign antibribery provisions contained in Sections 103 and 104 of the Act "have also been criticized as being vague and ambiguous", and (3) companies believe themselves to be at a "competitive disadvantage" in the absence of an international antibribery agreement. The GAO draft report further recommends that (1) the Securities and Exchange Commission (SEC) "develop a clear detailed standard" advising publicly held corporations of the degree of precision required in their recordkeeping under Section 102, and (2) the SEC and Justice "jointly develop alternatives to address the ambiguities surrounding the act's antibribery provisions."

In its organization, the report distinguishes between the two quite different portions of the Act, which are the domestic recordkeeping provisions of Section 102 and the foreign antibribery provisions of Sections 103 and 104. Since the SEC, which shares enforcement responsibility for the Act with the Department of Justice, will provide comments on the report's discussion of Section 102, the Department's

Much of our draft report is based on the results of our questionnaire survey of Fortune's 1000 industrials. Where appropriate, we have cited the results of other studies. These additional results, which we believe are pertinent, were in part used to complement and more importantly used to further validate the results of the corporate questionnaire. It is common practice to test the validity and credibility of study findings through comparison of data gathered from different survey methods and source groups.

We disagree with Justice's contention that our conclusions are premature. The Foreign Corrupt Practices Act has been in effect for more than 3 years. Concern over the clarity of the act's antibribery provisions has been expressed during virtually the entire period. For example, in September 1978, only 9 months after the act's passage, the President indicated that he was hopeful that business would not forgo legitimate export opportunities because of uncertainty about the application of the act. To address this uncertainty, the President directed Justice to provide the business community with guidance concerning its enforcement intentions under the act. Unfortunately, the Justice review procedure was not implemented until almost 18 months after the Presidential directive. This review procedure has been criticized by some government agencies and members of the business community as inadequate. In addition although our survey results show that serious ambiguities exist, only five companies have used the review procedure since its inception in March 1980.)

The GAO Survey

The conclusions of the draft report which relate to the antibribery provisions of the Act are troublesome, in part for the reason that the underlying survey is deficient in several crucial respects. Not only does the data generated by the survey fail to support the conclusions drawn by the draft report, but also the survey itself was fatally deficient in that the questions it contained ignored certain important distinctions which will be discussed later in these comments. In addition, the survey was not directed to a representative sample of the companies affected by the antibribery provisions of the Act.

The results of the survey are striking. Although the draft report cites the survey data to support the view that there are ambiguities in the Act which cause an unnecessary and substantial loss of foreign trade, those same survey statistics, in fact, provide evidence that such fears are unwarranted. For example, in question 33 of the survey, corporations were asked their opinion regarding the effect of the Act on their total overseas business. In response, a total of 87.3 percent of the companies acknowledged that the Act had

2. The survey was limited to publicly held corporations, thus excluding from review a major and important segment of the American export and import community, i.e., the privately held companies, ranging from the smallest exporters to some which are multi-billion dollar enterprises and all of which are covered by the antibribery provisions as "domestic concerns" (Section 104).4/

3. By randomly choosing for the survey some 250 companies out of the 1,000 largest industrial companies listed by Fortune magazine (see report Appendix II), the GAO built into its results some additional and unnecessary distortions. Not all of the 1,000 largest industrial companies are involved in any substantial way in the export or import markets and that may have distorted the survey results. Moreover, the Fortune list of the 1,000 largest industrial companies fails to include publicly held American companies which are very active in overseas markets because they are not considered to be "industrial" corporations. These include, for example, transportation companies, retail firms, computer software companies, engineering and architectual firms, as well as construction companies.

(GAO COMMENTS: In stating that only 12 questions deal with the antibribery provisions, Justice disregards questions in Part I of the questionnaire covering corporate policies and questions in Part II covering corporate audit and control procedures, which relate to the antibribery provisions.

We disagree with Justice that our random sample of 250 companies of the Fortune 1,000 industrials was inappropriate. These companies, approximately 80 percent of which conduct business overseas and which cover a wide range of industries, (see app. III) will give the Congress a good picture of the act's impact. It should be noted that the report that accompanied the House version of the act highlighted the importance of the Fortune 500 (our sample included the top 1,000) by indicating the need for the legislation. In this report, the House Committee on Interstate and Foreign Commerce stated that

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4/ Appendix II of the draft report indicates that responses from companies which were no longer publicly owned were excluded from the survey results. If the focus of the survey had been limited solely to the recordkeeping provisions of the Act (since Section 102 applies, in effect, only to publicly held companies) such a limitation would have been reasonable.

losses due to uncertainty about the application of the Act as contrasted to losses of the type clearly intended by the Congress when it enacted the statute.

With the exception of one half of question 37, none of the twelve questions in the survey which deal with the antibribery provisions of the Act focus on this important distinction. Moreover, even question 37 has serious deficiencies in that, _inter alia_, it asks about "the adequacy with which you feel the _text_ [of the Act] _clearly explains_" what is required to _comply_ with the Act (emphasis added). This type of question ignores the realities of law and business practice. The clarity of a complex criminal statute cannot be fairly tested only by an examination of the text of the statute. There are always terms of art used in drafting such legislation which have significance for lawyers, courts, and the Congress which would not be apparent to a lay person by simply reading the language of the statute.5/

(GAO COMMENTS: We disagree with Justice that the act's ambiguities and lost business were not adequately addressed by our questionnaire. A comparison of the responses to question 33 which covers how the act affected a company's overseas business to the responses to question 37 which deals with the clarity of the antibribery provisions clearly points out that companies reporting a decrease in business were much more critical of the clarity of the antibribery provisions than companies not experiencing a decrease.

For example, although 32 percent of the respondents indicated that they suffered a decrease in business they represented

—48 percent of the respondents who rated the clarity of the facilitating payments requirement as inadequate or very inadequate.

—48 percent of the respondents who rated the clarity of the questionable payment by foreign subsidiaries as inadequate or very inadequate.

5/ It is interesting to note that, notwithstanding the complexity of the statute, the answers to subparts 5 through 9 of question 37 (which deals with the antibribery provisions of the Act) indicate that as to some matters (subparts 5 and 7) more than 90 percent of the respondent companies found the statute to be adequate on its face. Even as to the more complex issue of corporate criminal liability for the acts of an agent (subpart 8), application of which is largely controlled by existing case authority, more than 60 percent of the respondent companies found the statute to be adequate on its face.

The discussion of the business views contained in the review was substantially based on individual anecdotal reports by businessmen. While many individual anecdotes were deleted from the final version of the review, the final version was nonetheless premised upon them. It was clear that a number of the anecdotally reported business losses did not occur because of uncertainty as to whether the Act would be violated, but for the reason that the transaction, if it had proceeded, would be in clear violation of the Act and thus was the very kind of transaction that Congress intended to prohibit when it enacted the statute. This was the primary reason that the Department could not and did not concur in the discussion contained in that review of business views. It was not at all clear that this anecdotal evidence supported the conclusions that were drawn that particular provisions of the Act were ambiguous and that ambiguity was causing losses of foreign business unintended by the Congress. The evidence remains unclear and thus, for the same reasons, the use of that material throughout the GAO draft report as a basis for GAO's present conclusions is questionable.

(GAO COMMENTS: Although the report prepared by the Department of Commerce and the Office of the U.S. Trade Representative was cited in our report, it was not the sole basis for our conclusions. Our conclusion concerning the act's ambiguities is based, in large part, on our questionnaire results.)

The FCPA Review Procedure

In response to concerns in the business and legal communities regarding perceived ambiguities in the Act, the Department formulated the Foreign Corrupt Practices Act (FCPA) Review Procedure in March 1980. The Review Procedure provides a means for individuals and corporations to submit a description of a prospective transaction to the Department which, after review, then advises the requestor whether an enforcement action will be taken if the transaction proceeds. Although only five review requests have been received, each of the four responses which have been publicly released thus far have dealt with significant areas of current concern about the Act.6/

6/ It is interesting to note that when the SEC solicited public comments regarding, *inter alia*, perceived ambiguities in the Act, only fourteen comments were received. After establishing an unusual new program such as the FCPA Review Procedure in order to assist in reducing perceived ambiguity, the Department has received only five review requests. With all of its defects, GAO's survey suggests that the vast majority of companies do not have problems with the Act, leave alone with ambiguities in the Act. Some might suggest that the American business community is having less of a problem with ambiguities of the Act than others would have one believe.

(GAO COMMENTS: Contrary to Justice's perception, a significant percentage of our questionnaire respondents perceive the antibribery provisions to be ambiguous. For example, more than 35 percent of the respondents rated the provision concerning a company's responsibility for the actions of foreign agents--a key provision—as inadequate or very inadequate. Another 17 percent of the respondents rated the clarity of the provision as of marginal adequacy.

In addition, as previously highlighted in our comments, companies that indicated they have lost business were more likely to rate the clarity of the antibribery provisions as inadequate or very inadequate.)

As the President's Report to Congress in September 1980 noted, the Departments of Justice and Commerce will, in the near future, jointly examine the effectiveness of the FCPA Review Procedure. Until such time as this joint review has been completed, conclusions such as those drawn by GAO in its draft report are premature.

(GAO COMMENTS: We disagree with Justice that our conclusions regarding the Justice Review Procedure are premature. As discussed previously the program has received substantial criticism from the business community and has been only nominally used. Pages 42 to 43 of our report discuss specific problems with the program on which we based our conclusions.

In this regard, Justice and Commerce announced in the January 28, 1981, edition of the Federal Register that they are seeking comments from the public regarding the effectiveness and the usefulness of the review procedure in reducing uncertainties about the meaning of any of the antibribery provisions. How effective this data collection and subsequent evaluation will be remains to be seen. Business views regarding the effectiveness of the review procedures were previously solicited. As discussed in our report, the September 1980 report prepared by the Department of Commerce and the Office of the U.S. Trade Representative reported a number of reasons that businessmen do not perceive the review procedure to be useful.)

In our judgment, a new GAO survey, conducted before the issuance of a final report and directed to a representative group of respondents, would be appropriate. The questionnaire should contain sharply drawn questions designed to discover if there are, in fact, serious perceived ambiguities in the Act and, if so, in which provisions. The Department of Justice is, of course, ready to provide whatever assistance

UNITED STATES DEPARTMENT OF COMMERCE
Office of Inspector General
Washington, D.C. 20230

February 3, 1981

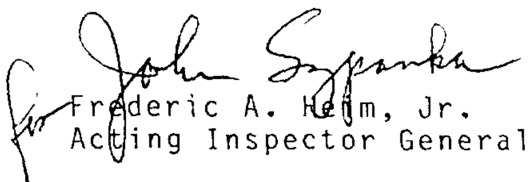
Mr. D. L. Scantlebury
Division Director and
Chief Accountant
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Scantlebury:

This is in reply to your letter of December 8, 1980, requesting comments on the draft report entitled "Foreign Corrupt Practices Act."

We have reviewed the enclosed comments of the Under Secretary for International Trade and believe they are responsive to the matters discussed in the report.

Sincerely,



Frederic A. Heim, Jr.
Acting Inspector General

Enclosure

Commerce staff have a number of specific comments on the draft GAO report. Some of the comments involve issues that are not covered in the draft report, but which the GAO may want to address in the final report. The comments are grouped by the accounting provisions and the corrupt payments provisions of the FCPA.

Accounting Provisions

1. The accounting provisions of the FCPA apply to "issuers," a term including companies that have securities registered pursuant to section 12, or that report pursuant to section 15(d), of the Securities Exchange Act. There is some question whether the accounting provisions apply to wholly or partially-owned domestic and foreign subsidiaries. The Securities and Exchange Commission (SEC) has taken the position that subsidiaries are covered (subsidiaries over 50 percent owned are covered; those 20-50 percent owned are also covered unless the issuer can demonstrate lack of control). However, the American Bar Association (ABA) Guide to Section 13(b)(2) states that subsidiaries generally are not covered. The ABA Guide adds that if a subsidiary's financial statements are material to the issuer's financial statements, then the accounting provisions probably apply to that subsidiary in order to permit the issuer to ensure that its own financial statements are prepared in conformity with generally accepted accounting principles.

   The Chafee bill (S.2763) resolves this question by providing that with respect to subsidiaries which are 50% or less owned by an issuer, the issuer's obligation under the accounting provisions is to "...proceed in good faith to use its influence, to the extent reasonable under the issuer's circumstances,...to cause transactions and dispositions of assets having a material effect on the issuer's interest in the foreign controlled firm to be carried out consistent with the purposes of the accounting provisions." Since the meaning of the term "issuer" affects the scope of the accounting provisions, the GAO may wish to address this question in its final report.

6. Information in the President's report to Congress on export disincentives indicates that lost U.S. export opportunities stemming from perceived ambiguities in the FCPA tend to be concentrated in less developed countries — precisely those markets which are major growth areas for U.S. exports. A discussion of the geographical impact of the Act would be useful, if it is possible to do so from the available data.

7. The discussion of the survey results should clearly establish whether, where, or to what extent respondents engage in overseas business. Such a clarification would avoid understating the impact of the FCPA by clearly identifying those responses from companies for which foreign operations are not significant in terms of overall operations.

8. During the preparation of the President's report on export disincentives, the business community indicated that dual enforcement of the bribery provisions of the FCPA by Justice and SEC has created confusion and has led to a loss of legitimate exports. The GAO reports correctly points out that dual enforcement was the intent of Congress, but it does not address the unintended effects of the loss of legitimate exports. Since this issue is of particular concern to exporters, GAO may want to consider reviewing the matter of dual enforcement.

GAO DRAFT REPORT: "THE FOREIGN CORRUPT PRACTICES ACT"

Following are the Department of State's comments and recommended changes in the draft GAO report:

1. Page iv, paragraph 3 - Revise second sentence to read as follows:

"The Justice guidance program is voluntary in nature but requires that participating companies submit a detailed statement...foreign country."

2. Page v, paragraph 3 - Revise fourth sentence to read as follows:

"The United States has recently mounted a new effort to negotiate an international agreement outside the United Nations, but the State Department is not optimistic that an effective agreement can be put into effect any time soon."

3. Page vi - We note that in the section on recommendations to the Attorney General and the Securities and Exchange Commission (page 49), the GAO recommends legislative proposals that would amend the Act's provisions. The State Department supports this approach and recommends that these legislative proposals be highlighted and summarized on page vi of the Digest.

4. Page 36, paragraph 2 - Second sentence should be revised to read as follows:

"No other nation has antibribery prohibitions similar...."

5. Page 36, paragraph 4 - Delete entire paragraph and substitute proposed language contained in Comment 2. above.

6. Page 45, paragraph 4 - Second and third sentences should be revised as follows:

Sentence 2 - Insert ", U.S. and non-U.S. alike," after the word "businesses."

Sentence 3 - Substitute the following language: "The UN has proved unable to achieve an international antibribery agreement."

7. Page 46, paragraph 2 - In first sentence, substitute "draft" for "write" and "illicit payments" for "corrupt practices."

with the summit countries, and any other interested States, on the commitment at Venice to seek to conclude an agreement among the summit countries but open to all with the objective of prohibiting illicit payments to foreign government officials in international business transaction."

8. Page 48, paragraph 5 - Substitute the following words after "among" and before "may be possible, etc."

"the U.S. and its principal economic industrialized allies"

9. Page 49, paragraph 3 - Revise line 1 of paragragh 3 to read as follows:

"Under this option, Justice, the SEC, and other interested agencies would offer legislative, etc...."

10. Page 4, paragraph 4 - The second sentence should be revised to read as follows:

"We recommend that Justice, the SEC, and other interested agencies in consultation with the Congress propose legislative reforms to improve the antibribery provisions of the Act. Such consultation should principally involve the Chairmen of the Senate Committee on Banking, Housing and Urban Affairs, and of the House Committee on Interstate and Foreign Commerce, Subcommittees on Oversight and Investigations, and on Consumer Protection and Finance."

Sincerely,

Elinor G. Constable
Deputy Assistant Secretary for
International Finance and Development

The remainder of page 46 should be deleted and the following language substituted instead:

"State Department officials report that, although the ECOSOC Committee completed its work on a largely unbracketed draft agreement on illicit payments in the spring of 1979, the ECOSOC and the UN General Assembly have each failed two years in a row to take any action to advance the long-standing U.S. initiative to conclude an agreement on illicit payments. The summit countries agreed at Venice in June 1980 to work in the UN toward such an agreement, but if that effort faltered, to seek to conclude an agreement amongst themselves but open to all with the same objective. President Carter in his September 1980 report to the Congress on export disincentives indicated the U.S. would make a further effort in the fall 1980 General Assembly session to schedule a conference to conclude an agreement. If the GA could not agree, the President said he would ask the other heads of government at the 1981 summit to direct the prompt negotiation of such an agreement among the summit nations but open to others.

At the 1980 GA session the U.S. held two rounds of consultations in New York with the G-77, summit and OECD countries seeking their support for the draft U.S. resolution to convene a conference in the first half of 1981 to conclude an agreement on illicit payments. We indicated the U.S. was prepared to consider the scheduling of a separate conference on the code of conduct later in 1981 but could not accept linkage of the two matters. The G-77 remained firm in support of tight linkage between the two conferences.

As no compromise was possible the U.S. delegation make it clear to the UN Community after fruitless consultations in New York that the U.S. had come to the conclusion that it was not possible to make further progress on illicit payments in the Untied Nations at this time. We believe that the good faith effort made by U.S. in New York to find a compromise that would permit a conference on illicit payments to proceed on its own merits fulfills the U.S. commitment at Venice to continue to work towards an agreement on illicit payments in the United Nations until that effort falters. Therefore, the U.S. intends to follow through

 APPENDIX VII

DEPARTMENT OF STATE
Comptroller
Washington, D.C. 20520

JAN 14 1981

Mr. J. Kenneth Fasick
Director
International Division
U.S. General Accounting Office
Washington, D.C.

Dear Mr. Fasick: Ken

I am replying to your letter of December 8, 1980, which forwarded copies of the draft report: "The Foreign Corrupt Practices Act"

The enclosed comments on this report were prepared by the Deputy Assistant Secretary for International Finance and Development in the Bureau of Economic and Business Affairs.

We appreciate having had the opportunity to review and comment on the draft report. If I may be of further assistance, I trust you will let me know.

Sincerely,

Roger

Roger B. Feldman

Enclosure:
As stated

GAO note: Page numbers in this appendix refer to the draft report and may not correspond to this final report.

2. The FCPA's qualifying language in the accounting provisions, that internal accounting controls be sufficient to provide "reasonable assurances," established the concept that the cost of internal controls should not exceed the benefits received. Yet the results of the GAO survey indicate that the costs involved in compliance efforts were perceived by most of the companies to exceed benefits received. This suggests there may be some confusion over what should be considered as costs and benefits. As part of GAO's recommendation to the SEC to develop a more explicit standard for complying with the accounting provisions, consideration should be given to clarifying the nature or concept of costs and benefits that are relevant to the balancing process.

3. There appears to be some controversy as to the standard of culpability that should apply in civil injunctive actions for violations of the accounting provisions. The SEC has announced that a negligence standard should govern in such cases. (Securities Exchange Act Release No. 34-14478.) Some members of the bar assert that the legislative history of the FCPA does not support that standard, and that a showing of "scienter" ought to be required to establish a violation of the accounting provisions. The GAO report makes reference to the Chafee bill (S.2763), which provides that liability under the accounting provisions would be limited to knowingly falsifying company books and records and intentionally wrongful maintenance of the internal accounting controls. The GAO may want to consider including a discussion of the merits of limiting such liability for violations of the accounting provisions.

4. There is disagreement whether a private right of action is available to anyone injured by violations of the FCPA, particularly for violations of the accounting provisions. The SEC has stated that the legislative history of the FCPA contemplates that private rights of action could be implied for persons who are injured as the result of unlawful bribery. The ABA Guide takes the position that there is no support in the language or legislative history of section 13(b)(2) for the imposition of such civil liability for violations of the accounting provisions. The issue is an important one, and the GAO should consider adding a discussion of this point.

Corrupt Payments Provisions

5. The FCPA affects the exports of both small and large firms. The GAO study is based on a sample of large corporations. In the course of preparing the President's report on disincentives, the Department received information from small and medium-sized companies which indicated that the potential adverse effects on their overseas operations (including forgoing exporting altogether) were greater than those of larger firms. One important reason is that smaller companies incur proportionately greater compliance costs, e.g., legal and accounting expenditures.

UNITED STATES DEPARTMENT OF COMMERCE
The Under Secretary for International Trade

JAN 27 1981

Mr. D. L. Scantlebury, Director
Division of Financial and General Management Studies
United States General Accounting Office
Washington, D.C. 20548

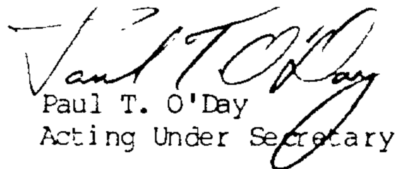
Dear Mr. Scantlebury:

Thank you for the opportunity to comment on the GAO draft entitled, "The Foreign Corrupt Practices Act: A Look at Its Impact on Business."

The President's Report to the Congress on Export Incentives and Potential Disincentives directed the Department of Commerce to examine the Foreign Corrupt Practices Act Review Procedure and to develop recommendations for improvement. Because the Department's work is not yet complete, we do not now have positions on the specific recommentations outlined in your report. However, I do note that the results of your study are in many respects congruent with those of the President's Report.

For your information and consideration, I have attached specific comments prepared by Commerce staff. We look forward to working with the Congress and the GAO staff in examining further the impact of this legislation on exporters.

Sincerely,



Paul T. O'Day
Acting Under Secretary

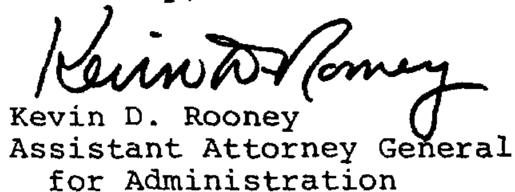
Enclosure

may be necessary to conduct such a survey. Congress would then be in a better position to draft legislative language to eliminate the unintended effects of the Act.

It may be that there are serious perceived ambiguities in the Act which are causing unintended losses of foreign business. If such is the case, the Department will clearly support amendment of the Act and provide any assistance possible in that effort. Thus far, however, there is insufficient evidence.

We appreciate the opportunity to comment on the draft report. Should you desire any additional information, please feel free to contact me.

Sincerely,



Kevin D. Rooney
Assistant Attorney General
for Administration

(GAO COMMENTS: Justice's Foreign Corrupt Practices Act Review Procedure was implemented in response to a Presidential directive. As discussed previously, the President, in September 1978, directed the Attorney General to provide guidance to the business community which would help reduce uncertainty about the meaning and application of the act's antibribery provisions. The President expressed concern over the potential effect of the act's alleged ambiguities. He stated that the act should not be viewed as an impediment to the conduct of legitimate business abroad and hoped that business would not forgo legitimate export opportunities because of uncertainty about applying the act. However, it was not until approximately 18 months after the President's directive that Justice's review procedure became effective. As reported on pages 42 to 43, the long awaited Justice program has received substantial criticism and has only been nominally used by the business community. The program has not effectively addressed the ambiguities and it is doubtful it will--at least in its present format.)

For those who have participated, the FCPA Review Procedure has been beneficial. We continue to be hopeful that the business community will use the FCPA Review Procedure in those instances when the application of the Act to a particular transaction may not be clear.

Response to GAO Recommendations

Based on its survey and review of previous reports, GAO recommends that Justice and the SEC jointly develop alternatives to address the "antibribery ambiguities" and suggests additional guidance through the publication of hypothetical examples of permissible and non-permissible conduct under the Act and/or "legislative proposals to reduce the ambiguities" such as "[1] the definition of foreign officials, [2] the responsibility of a company for the actions of foreign agents and officials, [3] the making of facilitating payments, and [4] corrupt versus non-corrupt payments." The draft report recommends that Justice and the SEC report to the Chairmen of the Senate and House committees by no later than April 30, 1981 on alternative ways to address the antibribery ambiguities.

These unqualified and broad recommendations are unsupported by the draft report. Close examination of the GAO survey data certainly does not reveal any clear or convincing evidence that the business community even perceives the Act to be ambiguous. To the contrary, the statistics suggest ambiguities are not a significant problem.7/

7/ We have not, in our comments, addressed a number of technical errors throughout the draft report with respect to the Act and its application. We are prepared to review these errors with your staff at an appropriate time.

—47 percent of the respondents who rated the clarity of the act's antibribery provision relating to a company's responsibility for actions of a foreign agent as inadequate or very inadequate.)

Earlier Studies of the Act

The importance of focusing on the difference between the intended effect of the antibribery provisions and business losses due to perceived ambiguities is further highlighted by the lengthy review in the GAO draft report of the work of the earlier White House task forces. For example, the survey of foreign service posts that was conducted by the State Department, and which is referred to at pages 18-19 of the draft report, was reviewed as part of an interm task force report to the President in February 1980. That survey suffered from the same deficiency that GAO's survey does -- that is, it did not distinguish between losses due to perceived ambiguities as constrasted to the Congressionally intended effects of the Act. Its value to the task force, for this reason, inter alia, was therefore severely diminished.

(GAO COMMENTS: As discussed above, our questionnaire results show that companies that lost business were more likely to rate the antibribery provisions as inadequate than those who did not lose business.)

Much of the discussion of the antibribery provisions of the Act contained in Chapter 4 of the GAO report summarizes material which was attached to a Presidential Report to the Congress in September 1980 made pursuant to Section 1110(a) of the Trade Agreements Act of 1979. Attached to that Report was a review, prepared by the Secretary of Commerce and the U.S. Trade Representative, of the views of various segments of the business community regarding, among other things the effect of the Act as a disincentive to American exports. As the President indicated in his report, that review was explicitly noted by the President as not representative of the Administration's policy and, as the footnote on page 9-1 of the review indicates, the Department did not concur in the discussion contained in that review.

(GAO COMMENTS: President Carter referred to the review of the Executive Branch Export Promotion Functions and Potential Export Disincentives as

"* * * the most comprehensive study of its kind ever undertaken by the U.S. government. It contains a considerable amount of information that must be weighted and examined, and will serve as a solid basis for future actions by the Federal government.")

"These corporations have included some of the largest and most widely held public companies in the United States: over 117 of them rank in the top Fortune 500 industrials."

As mentioned previously, Justice also failed to mention our two additional surveys of the leading companies in the aircraft and construction industries. Further, with regard to the impact on smaller companies, the Commerce Department in commenting on our draft report said that the adverse impact of the act is even greater on these companies, many of which are trying to enter the world market or expand their foreign sales.)

Aside from the defects in the survey which flow from not questioning the right companies, the survey is also defective because the wrong questions were asked of the companies surveyed, at least insofar as the survey questions related to the antibribery provisions of the Act. All of the White House task forces on export disincentives which reviewed the impact of the antibribery provisions on foreign trade were extremely careful to draw a very important distinction which is completely ignored by the GAO in its survey. There are obviously certain foreign transactions which the Congress fully intended to prevent when it enacted the Foreign Corrupt Practices Act, that is, any transactions which involve bribery of a foreign government official in clear violation of the provisions of the Act. Clearly, Congress intended that American firms would forgo such transactions and lose such sales if they could only be effected by means of bribery in violation of the Act. As a matter of public policy, the Congress made a judgment, by enacting this statute, that economic losses stemming from such lost business opportunities were appropriate. Absent a repeal of the Act, which few, if any, commentators have publicly advocated, such losses of business cannot and should not be avoided.

The export disincentive which was of concern to the various task forces whose work is reviewed in the GAO study is the unwarranted losses of foreign business that may be occurring because of perceived ambiguities in certain provisions of the Act or uncertainty as to how the Act will be enforced. The abandonment of a particular foreign transaction by an American company because of an unjustified fear that to proceed could involve a violation of the Act is the only type of economic loss that is at issue. This is the distinction with which the GAO survey does not adequately deal. For example, question 33 asks the extent to which ". . . the Foreign Corrupt Practices Act affected your total overseas business." Not only does the question not focus on the effect of the antibribery provisions as contrasted to the recordkeeping provisions, but it does not ask about business

"little or no effect" on overseas business or caused only "somewhat of a decrease in business."2/ Although 12 percent of the respondent companies claimed a "moderate" loss of business, less than 1 percent of the companies claimed a "great decrease in business" as a result of the Act. Similarly, in response to question 34, more than 87 percent of the companies participating in the survey indicated that foreign buyers or agents have been discouraged by the Act from doing business with the company "to little or no extent" or only "to some extent."3/

(GAO COMMENTS: Justice has quoted the statistics in a misleading way. Approximately 32 percent of the companies responding to our questionnaire reported that, as a result of the act, they have lost overseas business. Slightly less than 20 percent of the respondents characterized this loss as "somewhat of a decrease" while 12 percent of the respondents reported they have experienced a moderate loss of business. Less than 1 percent of the respondents reported a great decrease in business.

In addition, Justice fails to mention the results of our survey of leading companies in the aircraft and construction industries. As discussed on page 15, respondents to our questionnaire believed that companies in the construction and aircraft industries were more likely to be adversely affected by the act. Because of these perceptions, we sent additional questionnaires to a number of leading companies in these industries; 54 percent of the respondents reported that the act had adversely affected their overseas business.)

Thus, the survey results seem to suggest that the antibribery provisions have been much less a cause of loss of overseas business than some commentators have stated and this report has concluded. Frankly, however, we have serious doubts about the validity of the survey in drawing conclusions about the antibribery provisions for several reasons:

1. As the survey questionnaire indicates, the whole survey process was heavily weighted toward a study of the impact of the recordkeeping provisions of the Act (34 of 46 questions), and not the antibribery provisions (12 of 46 questions).

2/ Given the fact that the survey had a margin of error of plus or minus 7 percent, it is conceivable that more than 94 percent of the companies surveyed fell into this category.

3/ This figure could also be as high as 94 percent. See footnote 2 above.

comments will be confined to that portion of the report which deals with the antibribery provisions of the Act.

The draft report relies substantially upon the results of a survey conducted by the GAO beginning in December 1979 and upon various reports and reviews conducted by executive branch agencies concerned with issues relating to trade disincentives.1/

The Department's study of the GAO report has led it to conclude that the survey is deficient and does not support the proposition for which the survey is cited in the report. Moreover, to the extent that the report relies on data previously gathered by executive branch agencies, that data is equally unreliable as a basis for supporting the report's conclusions. Indeed, those conclusions are premature in light of the anticipated joint study of the Review Procedure by the Departments of Justice and Commerce.

(GAO COMMENTS: We disagree with Justice's claim that our report does not provide the Congress with the basic data it needs to assess the implementation and impact of the act. The results of our questionnaire survey complemented by the results of our additional review work should be of significant value to the Congress in its future deliberations of this controversial law. We believe the value of the GAO study was best expressed by SEC in its comments on our draft report:

> "The completion of the GAO study is an important event. The GAO's survey of 250 industrial corporations establishes an empirical data base which provides information that will assist the Commission, the Justice Department and the Congress in assessing the impact and implementation of the FCPA. As a result, the GAO's report constitutes a significant contribution to discussions concerning the impact and meaning of the Act."

1/ These include a September 1978 report of a White House Task Force on Export Disincentives; a February 1980 interim report of a second White House Task Force on Export Disincentives; and a Review prepared by the U.S. Trade Representative and the Secretary of Commerce which summarized the views of some members of the business community regarding the effect of the Act as an export disincentive. This Review was forwarded to the Congress by the President in connection with his Report to the Congress in September 1980, pursuant to Section 1110(a) of the Trade Agreements Act of 1979.

fact that the statutory standards require determinations as to a person's state of mind -- determinations that often require an evaluation of circumstantial evidence bearing on the question of intent. Hypothetical analysis is not suited to such an evaluation and could easily be misconstrued. Accordingly, it would not be appropriate for Justice and the Commission to "be jointly bound by any such guidance" as the GAO draft suggests (page 49). Finally, and perhaps most important, it would be unwise for the Commission to attempt to issue interpretations in the context of hypotheticals; the discipline inherent in dealing with a concrete set of facts, and with persons or entities who may express differing views as to proper application of the law, often bring to light issues and problems that would not be immediately apparent in a hypothetical situation. This results in a more sound and judicious decisionmaking process.

(GAO COMMENTS: We disagree with SEC's perception that hypotheticals would be of limited value. Instead we believe well-constructed hypotheticals could be of significant value in identifying the significant ambiguity problems. To assure that these hypotheticals are well constructed, we recommend that the Departments of Commerce and State and the U.S. Trade Representative be included in this process.

We disagree with SEC's contention that it would be inappropriate for Justice and SEC to be jointly bound by the same guidance. SEC's position is inconsistent with its current program to abide by Justice's review letters until May 1981. More importantly, SEC's position is inconsistent with congressional intent. For example, the report accompanying the House version of the act indicated that Justice and SEC have developed a close working relationship which should continue as they enforce this law. As stated in our report, we strongly believe that companies should be subject to clear and consistent demands by the Government agencies responsible for enforcing the act.)

(GAO COMMENTS: We disagree with SEC's assertion that we do not discuss how the desire for greater clarity could be reconciled with congressional policy. We believe that the ambiguities highlighted on pages 38 to 41 could be reduced through implementation of our recommendations. We reject the argument that clearing up existing ambiguities--which, in part, may have caused U.S. business to forgo legitimate export opportunities--would not be consistent with the act the Congress passed. Further, the Congress expected that SEC and the Department of Justice would work closely to carry out the provisions of the act. Although Justice developed a program to assist businesses, SEC has only agreed to be bound by Justice's opinion until May 1981.)

B. The Relationship Between the Commission and the Justice Department's FCPA Review Procedure

Because the FCPA Review Procedure is a program of the Department of Jusice, we do not have detailed comments concerning the portion of the draft report that discusses the review procedure. However, the reference at page 42 to the Commission's position "that it will not take enforcement action against any company that receives a favorable Justice review letter" under that Procedure should be qualified to make clear that it applies only to review letters issued prior to May 31, 1981. As the report subsequently notes, the Commission will review its position, prior to that date, to determine what, if any, further action it should take.

The draft report is inaccurate in asserting that Commission participation in the FCPA review procedure "would have been in line with SEC's current policy of issuing administrative interpretations of laws and regulations when requested by interested parties" (page 44). The draft report fails to understand the nature of the administrative interpretations that the Commission does issue. These interpretations are provided to assist persons and entities in complying with provisions that, unlike the antifraud provisions and the bribery prohibitions, are of a technical and regulatory nature. In contrast, Sections 103 and 104 of the FCPA proscribe the making of any payment or gift "corruptly" to a foreign official, political party, or candidate for foreign political office in order to assist in obtaining, retaining, or directing business to any person. The determination of whether or not a person subject to those provisions intends to make a payment or gift "corruptly" will often require an evaluation of circumstantial evidence to determine whether the person making the payment or gift did so with a "corrupt purpose." Accordingly, the nature of the inquiry differs significantly from that involved in providing interpretations of regulatory statutes or rules that do not turn on the question of intent, or in issuing "no-action" letters in the context of such provisions — a method that the Commission has long employed to provide guidance to the public. Under these circumstances, it appears that questions concerning the motive or intent of those engaging in conduct which appears to come within the terms of the FCPA can best be resolved by corporate officials and their professional advisers, who have access to all the relevant facts bearing upon intention.

(GAO COMMENTS: We believe that our questionnaire results show a significant percentage of companies who believe the act's antibribery provisions are not clear. For example, more than 35 percent of the respondents rated the provision concerning a company's responsibility for actions of foreign agents--a key provision--as inadequate or very inadequate. Another 17 percent of the respondents rated the clarity of the provision as of marginal adequacy. Also, as previously stated companies indicating that they have lost business are more likely to rate the clarity of antibribery provisions as inadequate or very inadequate.

We believe that the low response rate SEC received was substantially influenced by a number of factors unrelated to the ambiguity problem, including

--the timing of SEC's request for public comments;

--SEC's refusal to participate in Justice's Business Review Program; and

--a prior published quote, reportedly made by the Director of SEC's Enforcement Division, which strongly criticized business' need for guidelines to reduce the ambiguities.

SEC's release that requested public comments appeared in the February 26, 1980, Federal Register--about one month before the start of Justice's Business Review Procedure. Therefore, for much of the 4 months the comment period was open, the Justice Business Review Procedure was in operation. This raises some question about SEC's timing in announcing the program. It is not surprising now that business had a program which supposedly would address any ambiguities that there was no need to expend corporate funds to assist SEC to ascertain the extent to which criticisms of the act had substance.

In addition to what appears to be poor timing, SEC had, before issuing the release to the public, refused Justice's request to participate in the Foreign Corrupt Practices Act Review Procedure. What effect this refusal had on the public's motivation to respond to SEC's request is hard to assess. However, it is logical to conclude that it had some effect.

Another factor that may have had an impact on the low response rate concerns a published quote reportedly made by the Director of SEC's Enforcement Division. The Director had been quoted as saying that

> "We do not have guidelines for rapists, muggers and embezzlers, and I do not think we need guidelines for corporations who want to bribe foreign officials."

(GAO COMMENTS: SEC has distorted the results of our questionnaire. Approximately 32 percent of those responding to our questionnaire reported that, as a result of the act, they lost business overseas. Approximately 20 percent of the respondents characterized this loss as "somewhat of a decrease," not a "minor" decrease as stated by SEC. SEC also fails to mention the results of our surveys of leading companies in the aircraft and construction industries in which more than 50 percent of those responding indicated that the act has caused them to experience a loss in business. We believe that these percentages are significant and deserve close attention by the Congress. We strongly question SEC's assertion that most of the lost business reported above involved transactions that are clearly prohibited by the bribery provisions. We are unaware of any SEC, or for that matter any study, that supports, or would lead SEC to reach, such a conclusion. In fact, our questionnaire responses show that at least in part the lost business is due to the ambiguities in the antibribery provisions. A comparison of the results of question 33, which asks how the act has affected a company's total overseas business--to the results of question 37, which deals with the clarity of the antibribery provisions--shows that companies that reported a decrease in business were much more critical of the clarity of the antibribery provisions than companies who didn't experience a decrease. For example, while 32 percent of the respondents indicated they suffered a decrease in business, these respondents represented

--more than 48 percent of the respondents rating the clarity of the facilitating payments requirement as inadequate or very inadequate.

--48 percent of the respondents rating the clarity of the questionable payment by foreign subsidiaries as inadequate or very inadequate.

--47 percent of the respondents who rated the clarity of the act's antibribery provision relating to a company's responsibility for actions of a foreign agent as inadequate or very inadequate.)

Despite the survey data reflecting that the bribery provisions have been effective in achieving the purposes the Congress sought to achieve, and are not as ambiguous as some have suggested, the draft report deals exclusively with allegations that confusion exists "over what constitutes compliance with the Act's * * *" prohibitions against bribery (see page 36). The draft report adds, despite the survey data noted above, that these alleged ambiguities "have been cited as possibly causing U.S. companies to forego legitimate export opportunities."

As in the case of the accounting provisions, the draft report repeats these criticisms, as if they should be accepted at face value, without an independent analysis of whether they actually have merit. For example, there is no analysis of the implications of the survey data noted above. The empirical data compiled in response to the GAO's questionnaire indicate

E. The GAO Recommendation Concerning the Accounting Provisions

The GAO draft recommends that the Commission, "with input from Justice, the corporate community and the accounting profession, develop an explicit standard or standards * * * which clearly tells companies the degree of precision needed to comply with the Act's accounting provisions (page 35). The report adds, "[t]his clear detailed standard should contain definite thresholds for compliance."

Although we have pointed out instances where we believe the draft report is not supported by the record of the Commission's enforcement actions in administering the FCPA, or by the results of the GAO survey on which the draft report is based, and identified a number of considerations that are often overlooked by critics, the Commission can acknowledge that at least some of the concerns that have been expressed have a degree of merit. A number of these concerns were recognized, for example, in Chairman Williams' statement of the Commission's policies before the AICPA.

With respect to the recommendations in the GAO's draft, which appear to be made within the framework of the existing law, we are not sure what is intended when the draft report calls for a clear definite quantitative threshold that will "clearly tell companies the degree of precision needed to comply with the Act's accounting provisions" (page 35). First, it should be noted that the differences in the two accounting provisions require different standards adapted to the purposes of each section. In addition, the recommendation appears to contemplate some kind of an arithmetical standard that could be inconsistent with the principle of maintaining accountability for assets and too rigid and inflexible to be practicably applied, given the vast differences in the circumstances of the issuers subject to the accounting provisions.

For example, in the context of the recordkeeping provision, does a "clear definite quantitative" threshold mean that transactions may be recorded at an amount that differs by 5%, 10% or even 25% from the amount at which it occurred, or is GAO suggesting that the Commission propose that transactions below some arbitrary figure such as $10, $100, $1,000 or $10,000 need not be accurately recorded? With respect to the internal accounting controls requirement, is the GAO suggesting an across-the-board rule that companies may disregard the risk of loss of cash or other assets as long as it is below some arbitrary figure such as $500, $5,000, $25,000 or more? If this is not what is contemplated, precisely what does the draft report suggest?

In this context, the GAO recognizes that a "materiality" standard could establish "a benchmark below which questionable corporate practices may be exempt" (page 33). Accordingly, the GAO recommends (id.) that:

> "qualitative characteristics in addition to quantitative thresholds be developed. An example would be a requirement that all intentional actions by top corporate management are material regardless of the dollar amount."

(GAO COMMENTS: There is a difference of opinion between SEC and the ABA committee guide as to whether a materiality standard is included in the act's accounting provisions. Irrespective of whether such a standard exists, it is an overstatement for SEC to contend that Congress explicitly rejected the concept of a materiality statement. We found no evidence in the legislative history that Congress substantively considered and explicitly rejected a materiality standard.)

Similar problems exist with the assertion (page 27) that "all of the accounting officials we contacted believe that without a materiality standard it is unclear as to the effort required to comply with the Act's accounting provisions." The draft report subsequently reflects (page 31) that the "public accounting firms we contacted" made their comments in response to a Commission rule proposal — a proposal that was subsequently withdrawn — which would have required each issuer to issue an annual statement to shareholders concerning its system of internal accounting controls, together with an auditor's report on management's statement. Placed in the context of that rule proposal, these statements appear to reflect a concern that, "[t]he inapplicability of a materiality standard [to management's <u>representation</u>] creates the potential for limitless compliance costs, <u>placing the burden</u> on the auditors * * *." Moreover, the draft report summarizes the accountant's comments as stating, "[i]t is unrealistic for the SEC to require management <u>to</u> <u>represent</u> that reasonable assurance, without regards to materiality has been achieved" (emphasis added). These statements make clear that the accountants' comments in question are directed, <u>not</u> to compliance with the language of the accounting provisions, but <u>instead</u> to perceived problems that issuers and auditors would have in complying with the Commission's rule proposal. As a result, it appears inaccurate to state "all of the accounting officials we contacted" believe that a materiality standard "is needed" to provide guidance as to compliance with the Act.

(GAO COMMENTS: Although comments to an SEC release were used to highlight the public accounting firms' positions, the statement in our report that "without a materiality standard it is unclear as to the effort required to comply with the act's accounting provisions" was based on the results of GAO contacts with 11 large public accounting firms. In addition, SEC's response implies that its rule proposal was not related to the act's accounting provisions, although the proposal specifically mentioned that the act had heightened business's concern over internal control system reliability. In our view, comments in response to the SEC proposal indicated, among other things, concern over compliance with the act's internal control provisions.)

Although the draft GAO report is correct in noting (see page 21) that the principle area of controversy has been over "<u>whether</u> the provisions

D. The Issue of Materiality

The draft report notes the criticisms of some members of the business community that compliance with the internal accounting controls requirement will be too costly in the absence of a materiality standard (see page 21). However, the absence of a materiality standard in the internal accounting controls requirement does not mean, as some persons apparently assume (see page 31), that a system of internal accounting controls is required to provide absolute assurances "that prohibited practices will not occur, however minor in amount." This should be apparent from the discussion set forth above. Such a system would not be cost-effective. In addition, the Congress explicitly recognized that no system of internal accounting controls is expected to be perfect. 40/ Similarly, the Commission has made clear that the provision does not require "a fail-safe accounting control system" without regard to the costs involved. 41/

The concerns expressed with respect to the "reasonable assurances" standard, like those voiced with respect to the recordkeeping requirement, ultimately reflect a concern for the liability consequences of a failure to comply. To a certain extent, these concerns reflect a lack of familiarity with the reasonable assurances standard and the fact that the "state of the art" with respect to cost-benefit analysis is undergoing change and development. They overlook the fact that the statute accords management a broad range of discretion and that persons and entities will not be held liable unless they have exceeded the bounds of that discretion.

(GAO COMMENTS: We disagree with SEC's statement that these concerns ultimately reflect concern about the liability consequences for a failure to comply. As we stated previously, given the potential penalties facing violators, certainly that is an important consideration. However, it should be noted that companies are also concerned because of the costs, excessive in many cases, needed to comply with what they perceive as unclear provisions. We recognized this concern in recommending that the Congress remove the criminal penalties for violation of the act's accounting provisions.)

The draft report asserts (page 27) that 70% of the respondents to the GAO questionnaire held the view that a materiality standard "is needed" to tell issuers what degree of "effort" is required to record transactions accurately and devise and maintain an adequate system of internal accounting controls. This statement is not consistent with the data the GAO received in response to the questionnaire. Question 37 asked respondents, among other things, whether the text of the accounting provisions "clearly explains what is expected from your company in order to be in compliance" with respect to the "issue of materiality" (emphasis added); it did not ask whether compliance would be unreasonable without such a standard.

40/ See S. Rep. No. 95-114, supra at 8.

41/ See Securities Exchange Act Release No. 15772, supra.

In the Commission's view, as stated by Chairman Williams in his address to the AICPA:

> "The test of a company's control system is not whether occasional failings can occur. Those will happen in the most ideally managed company. But, an adequate system of internal controls means that, when such breaches do arise, they will be isolated rather than systemic, and they will be subject to a reasonable likelihood of being uncovered in a timely manner and then remedied promptly. Barring, of course, the participation or complicity of senior company officials in the deed, when discovery and correction expeditiously follow, no failing in the company's internal accounting system would have existed. To the contrary, routine discovery and correction would evidence its effectiveness."

(GAO COMMENTS: We believe that this statement clearly points out the difficulty business faces in complying with the act. The Chairman noted that regardless of how technically sound and documented an internal control system is, the "last analysis" is keyed to actions of the corporate board of directors and top management. This is indeed a highly subjective judgment which clearly demonstrates why more guidance is needed.)

(b) Cost-Benefit Judgments

There is an important consideration that is often overlooked by persons who complain that the "reasonable assurances" standard lacks clarity. Although it may be difficult, and often impossible, to make an objective determination as to the precise point at which the costs of a particular internal accounting control may exceed its anticipated benefits, the law does not require that such a precise point be determined. The law merely requires a reasonable determination that the costs would be more or less than the benefits that may be anticipated. Moreover, although precise determinations will often be impossible because of the judgments and estimates that are necessary, most cost-benefit judgments will usually fall clearly into either the "more than" or "less than" category. It is only when the relative costs and benefits are approximately equal that there may be a question as to whether a particular change would be cost-effective; but in those situations, given the difficulties in making a precise cost/benefit analysis, there is a measure of discretion accorded to management as to what actions, if any, should be taken. And, unless management exceeds bounds of a reasonable exercise of that discretion, there would not be a violation. That this should be the case is consistent with the intent of the Congress, noted above, that the internal accounting controls provision should be a self-regulatory measure.

Accordingly, in our view, changes are required in a system of internal accounting controls only if: (a) there is a deficiency in the system of internal accounting controls which produces a risk that transactions will be effected without proper authorization, or that transactions will not be recorded as necessary to prepare financial statements or to maintain accountability for assets, or that one of the other statutory objectives will not be met; (b) there are control procedures available which could be implemented in order to reduce the risk involved; (c) management determines that

The draft report correctly notes (page 22) that the reasonable assurances standard is intended to make clear that "the cost of internal control should not exceed the benefits to be derived" from such a system. The benefits "consist of reductions in the risk of failing to achieve the objectives" that the statute sets forth for a system of internal accounting controls. 37/ Unfortunately, the draft report fails to recognize that this standard provides a standard of compliance that does include a quantitative threshold. In addition, the standard also serves to limit the potential liability of the issuer and senior corporate officials for possible infractions.

(GAO COMMENTS: We disagree with SEC's contention that the reasonable assurance standard, as presently defined, provides a standard of compliance that includes a quantitative threshold. In his January 13, 1981, speech, regarding the degree of exactitude required to comply with the accounting provisions, Chairman Williams stated that the act in essence provides a de minimus exemption, though not in quantitative terms. He acknowledged that "many persons, however, have not been comfortable with such a fluid legal standard".)

Contrary to the views expressed in the draft report and by some members of the business community to the effect that the reasonable assurances standard is unclear, the internal controls provision is explicit in two important respects:

(1) it requires management to "devise and maintain" a system of internal accounting controls designed to achieve the objectives set forth in the statute; and

(2) in the course of carrying out that mandate, management is permitted to delimit its obligation by determining whether existing or potential internal accounting controls will be cost-justified in terms of the benefits they may be expected to produce.

(a) Deference to Managerial Judgments

The statute and the legislation also make clear that corporate managers are accorded a broad range of discretion as to the means by which these explicit mandates are to be carried out. There are salient reasons why this is true which the draft report fails to acknowledge. First, subject to the accounting provisions are approximately 9,000 public companies which range from relatively small companies with approximately one million dollars in assets and 500 or more shareholders to the giant-sized corporations included in Fortune's list of the 1,000 largest industrial firms. In view of the vast differences in the circumstances of these issuers, it should be apparent that "what constitutes compliance" may, and should, be different for each of the companies subject to the accounting provisions. Government prescription of what each individual company must do to comply would be wholly impractical

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37/ See Section 320.28 of SAS No. 1.

for doing so in the accounting literature. Although this view has been voiced by critics of the Act, presumably in an effort to limit possible liability for inadvertent or insignificant errors, it is important to understand the nature of the competing policy considerations that are implicit in such an approach. On one hand, the legislative history reflects the desire of the Congress to emphasize the fundamental principle that all transactions and dispositions of assets should be accurately accounted for in a company's books and records — a principle that the statute refers to as the maintenance of accountability for assets. On the other hand, there is undoubtedly merit in the proposition that an inadvertent or insignificant error does not require the government to "roll out the federal artillery" in order to redress the problem. The critical question is how to reconcile the latter proposition with the principle that all corporate transactions should be accurately recorded in the company's books and records without, at the same time, condoning the falsification of corporate books and records or other improper practices.

In this context, the draft report recognizes, correctly in our view, that the use of a traditional materiality standard as a quantitative threshold would establish "a benchmark below which questionable practices [with respect to the recording of transactions] may be exempt" and "could weaken the present intent of the accounting provisions to enhance corporate accountability over assets" (page 34). 34/ However, the draft report then recommends that the Commission "develop" an "explicit standard" (see page 35) that will prescribe "lower quantitative thresholds" than the traditional standard of materiality. Except for one rather brief statement (see page 33), the draft report fails to point out that a quantitative threshold suggests that persons may falsify corporate records, as long as it involves an amount below that threshold figure. Nor does it contain any discussion as to how the concept of falsification below a threshold amount might be reconciled with the goal of maintaining accountability for assets. 35/

34/ Some have suggested that a "materiality" standard be used as a quantitative threshold, but these persons have overlooked the fact that "materiality" is a standard for limiting liability for inadequate disclosure to investors and is not a standard for deciding the degree of precision necessary to record a transaction accurately. If materiality was the standard, and a transaction was not "material" to investors — i.e., one that a reasonable investor would consider important in making a decision to buy, sell or hold securities — the transaction would not have to be recorded, in any manner, in the books and records of an issuer. As the GAO draft correctly points out, this could include transactions involving large amounts of corporate assets (see page 33).

35/ In its recommendations, the GAO draft does suggest, again without discussion, that there should be "a [qualitative] requirement that all intentional falsifications by top corporate management * * *" should constitute violations "regardless of the dollar amount." This formulation would permit intentional falsifications by employees below the level of top management, as long as they were below the threshold that the draft report recommends.

(GAO COMMENTS: We agree with SEC that it is important to note the legislative history of the accounting provisions. Pages 20 and 29 of our report adequately discuss why the accounting provisions were enacted in their present form.

We disagree with SEC's contention that the policy considerations regarding the reasonable detail and reasonable assurance provisions are very different. Both provisions are modified by the key term "reasonable." In addition, the relationship of the accounting provisions should be noted. In his January 13, 1981, speech to the AICPA, Chairman Williams stated that the recordkeeping provision is intimately related to the requirement for a system of internal accounting controls and that records that are not relevant to accomplishing the objectives specified in the statute for the system of internal control are not within the purview of the accounting provisions.

Distinctions that do exist between the interrelated accounting requirements can, in our view, be recognized through SEC guidance on the criteria and factors that will be taken into account in assessing compliance. In this regard, Chairman Williams' January 13, 1981, speech touched on certain considerations relating to compliance with the recordkeeping violations. These include involving top management in the violation and the corrective actions taken after a violation is uncovered.)

1. "In reasonable detail"

In order to understand the "in reasonable detail" standard, it must first be understood that it deals with the recording of individual corporate transactions and dispositions of assets. The recording requirement is addressed to the issuer and the employees of the issuer who are responsible for entering transactions on the books and records of the company. In this context, although there are concerns of substance with respect to liability for a failure to comply, claims of confusion as to "what constitutes compliance" appear to have little merit.

The recordkeeping requirement requires issuers to "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" (emphasis added). With respect to claims of a lack of "clarity," the statute, in essence merely requires that transactions be accurately recorded. As the authoritative auditing literature points out, transactions should be recorded "at the amounts and in the accounting periods in which they were executed and be classified in appropriate accounts." 31/

31/ Statement on Auditing Standards No. 1, Section 320.38.

Alternatively, some members of the business community have expressed a desire for "guidance" in the form of a checklist of actions that could be taken to comply with the internal accounting controls requirement. Such a checklist would be of limited value, however, because it would have to be comprehensive in order to cover every possible action that might be necessary. Even aside from the difficulty of drafting such a comprehensive list, many actions would inevitably be listed that would be appropriate for some issuers, but inappropriate for other issuers facing different situations. Moreover, an issuer would not necessarily be required to take any action on the list in order to comply with the Act. Accordingly, an issuer that viewed such a checklist as a guide to "what constitutes compliance" might incur excess costs by taking actions that are neither appropriate under facts and circumstances of that issuer, nor required by the "reasonable assurances" standard. 27/

> (GAO COMMENTS: We agree with SEC that developing a detailed checklist of actions that could be used to comply with the act's internal accounting control requirement would be difficult to draft and may be of limited value. However, as discussed previously, we are not calling for such an effort. We have clarified our final report to call for SEC to provide guidance to business on the factors and criteria that will be taken into account in assessing reasonableness.)

The mere fact that prescribed actions were taken would not necessarily result in compliance; one would also have to consider how an action was carried out in order to assure that it reflects the kind of action that would be expected of a reasonable and prudent corporate official and does not in fact elevate form over substance. Thus, in the final analysis, corporate officials will still have to exercise discretion and judgment as to what actions are appropriate with respect to their company, no matter what "guidance" may be provided as to compliance with the accounting provisions.

Another important consideration, which many critics of the FCPA fail to understand, is that the accounting provisions are, in a very real sense, intended to be a self-regulatory measure. The Congress anticipated that the Commission would leave the initial judgments as to what actions are appropriate to the management of reporting companies. The Commission is expected to intervene only in those limited instances in which it has reason to believe that a company's management has deviated from the norm of reasonable and prudent conduct. In this context, the Chairman of the Commission, Harold M. Williams, has stated his view that the accounting provisions are designed "to reduce the need to invoke the processes of the federal bureaucracy by making clear that primary responsibility for the

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27/ The reasonable assurances standard is discussed infra.

criticisms of the accounting provisions, without any corresponding evaluation of the merits and shortcomings of such criticisms, may be misleading by not providing a sufficient basis for the Congress to separate those criticisms that have merit from those that do not. In addition, we are concerned that unless the present Congress is fully apprised of the reasons why the statute was enacted in its present form, and what kinds of changes are consistent with the multiple purposes of the statute and what are not, possible amendments to the accounting provisions may be perceived by the business community as more confusing and burdensome than the existing law.

The issue of materiality provides one illustration of this important point. As the draft report notes (page 21), some members of the business community perceive compliance with the accounting provisions as being too costly in the absence of a materiality standard and bills have been introduced in the Congress that would add a "materiality" standard. But the GAO's draft report also recognizes (pages 31-34) that such a change could "establish a benchmark below which questionable corporate practices may be exempt" (page 33) and "could weaken the present intent of the accounting provisions to enhance corporate accountability over assets" -- an aspect of the Act that many critics have overlooked. This is the kind of useful analysis and balance that is needed if the Congress is to be able to sort out which proposed changes in the law may be appropriate, and which are not consistent with the purposes that an earlier Congress sought to achieve in adopting the accounting provisions.

B. The Focus on What Constitutes Compliance Reflects a Fundamental Misunderstanding of the Law

As noted above, the draft report asserts that "[t]he business community has criticized the accounting provisions as being "too vague to provide guidance on how sophisticated an accounting system needs to be to constitute compliance" (page 21). The draft also states that "critics emphasize that * * * [the Act] lacks objective criteria for determining whether a recordkeeping or internal control deficiency is a violation" (page 23). The GAO apparently agrees with these criticisms (see pages 21 and 23) and independently asserts that the "accounting provisions are inherently subjective and can be interpreted differently" (page 21; see pages 26-27 and 35).

The discussion in the draft report does not consider the fact that the "in reasonable detail" and "reasonable assurances" standards, like the "materiality" and "negligence" standards applicable in other areas of the law, are considered "objective" standards. These standards are considered "objective" in the law because a court faced with determining whether a violation has occurred must look, not to the subjective state of mind of an individual defendant, but to an objective standard -- whether the defendant failed to act as a reasonable and prudent person would have acted under the same or similar circumstances. In addition, each of these standards necessarily requires that any finding of violation be based upon an assessment of all of the relevant facts and circumstances -- after conduct at issue has occurred -- to determine if it measures up to that standard.

(GAO COMMENTS: By quoting only selected responses regarding the clarity of the bribery provisions, SEC significantly understates the problem. Question 37 contains five segments dealing with the antibribery provisions. SEC chose to quote the one that received the lowest adverse rating. For example, SEC failed to note that more than 35 percent of the respondents rated the provision concerning a company's responsibility for actions of foreign agents--a key provision--as inadequate or very inadequate. Another 17 percent of the respondents rated the clarity of the provision as of marginal adequacy. In addition, our final report (see p. 38) shows that companies indicating they have lost business were more likely to rate the clarity of antibribery provisions as inadequate or very inadequate.)

Chapter 3: CONTROVERSY AND CONFUSION OVER THE ACT'S ACCOUNTING PROVISIONS

A. Introduction

The draft report asserts that the "accounting provisions have been steeped in controversy and confusion" and states that "[t]he business community has criticized the provisions as being too vague to provide guidance on how sophisticated an accounting system needs to be to constitute compliance" (page 21). 24/ It alleges that "[t]here is much confusion over terms such as "reasonable assurances" and "in reasonable detail" and that the accounting provisions must be given "low marks on clarity" (page 23). In addition, it asserts that the "accounting provisions are "inherently subjective * * *" (page 21) and lack "objective criteria for determining whether a recordkeeping or internal control deficiency is a violation" (page 23). Finally, the draft report states that, absent a materiality standard, "compliance with the provisions is perceived by the business community as being too costly" (page 21).

Unfortunately, the GAO draft repeats these criticisms, as if they should be accepted at face value, without pointing out that the criticisms have often been based upon faulty premises. Although critics are entitled to their own opinions, the Congress should be made aware that many critics have tended to: (a) overlook the fact that the accounting provisions are intended to promote improved accountability for the use and disposition of corporate assets, as well as to assure that reporting companies will be able to prepare reliable financial statements in accordance with generally accepted accounting principles; 25/ (b) mistakenly assume that, in the absence of a materiality

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24/ The draft report overspeaks when it refers to the "business community". We suggest that the report be qualified to reflect that some, rather than all, members of the business community have expressed such sentiments.

25/ An illustration of this overlooked point is the ABA Guide to the accounting provisions which is often referred to in the draft report. The draft report does not even mention this fundamental shortcoming in the ABA Guide's reasoning and analysis.

We disagree with SEC's conclusion that the cost burden statistics developed from our questionnaire indicate that the reasonable assurance standard is not ambiguous and confusing as some have suggested. The statistics clearly show that the majority of the corporate community is incurring costs that exceed the benefits derived despite SEC's contention that the reasonable assurances limitation makes it "clear" that the costs of internal accounting controls are not required to exceed the benefits. Also, the legislative history shows that the Congress believed compliance with the accounting provisions would not result in costs which exceeded the benefits derived.)

B. The Bribery Prohibitions

The GAO's draft report also provides empirical evidence that the bribery provisions have been a striking success. For example, 76.5% of the respondents stated that the Act "has" or "probably has" been effective in reducing questionable corporate payments abroad. Only 5% asserted that the Act "has not," or "has probably not," been effective.

Although there have been widespread assertions that the FCPA has caused American companies to lose business, the GAO report notes that these claims "are not supported by hard verifiable data." The GAO's survey data (but not its report) indicates that, while there has been some lost business, this has been a much less serious problem than many have assumed. Indeed, less than one percent reported any serious loss of business. Nearly 68% of the respondents that engage in overseas business reported that the bribery prohibitions have had little or no effect on such business. In addition, if those reporting only a marginal decrease in business are included, the GAO survey indicates that 87.5% of the respondents either experienced no loss in business, or only a minor decrease in business. Inexplicably, this point is not made in the draft report. In contrast, only 12% of the respondents reported a decrease of business that could be characterized as "moderate" and less than 1% of the respondents indicated that they had suffered a "great decrease" in business. 22/

(GAO COMMENTS: SEC has quoted the statistics from our questionnaire in a way that could be misleading. About 32 percent of the respondents reported that, as a result of the act, they have experienced a decrease in overseas business. Approximately 20 percent of the respondents characterized this loss as "somewhat of a decrease"--not a "minor" decrease as reported by SEC. Moreover, results of the questionnaire sample can be statistically projected, showing

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22/ Since the draft report does not reflect the number of respondents that did have foreign business, we are unable to determine the number of these respondents as compared with the universe of 185 respondents to the questionnaire. For example, the .6% experiencing a "great" decrease in business could mean that anywhere from one to eleven companies experienced such a decrease.

Although it may be true that some corporate officials did expend more than was cost-effective in the initial period of uncertainty after the enactment of the statute, the GAO's data indicates that this was not a serious problem for three out of five of the respondents surveyed. Moreover, it has now been three years since the FCPA was enacted. During that period numerous articles have been written concerning the subject of internal accounting controls and guides have been prepared by accounting firms to assist reporting companies in complying with the terms of the accounting provisions. The Commission has also provided guidance as to how the accounting provisions should be interpreted and implemented 20/ and has adopted rules which prohibit the falsification of corporate books and records and the making of false or misleading statements to an accountant in the course of an audit or the preparation of a document for filing with the Commission. 21/

(GAO COMMENTS: We based our conclusion about the cost burden of the act on our questionnaire results. As SEC points out, 56.4 percent of our respondents believed that the cost of compliance exceeded the resulting benefits to their corporations. Since our questionnaire results are statistically valid and can be projected, this means that about 564 companies in the Fortune 1000 list share this perception. Moreover, as we previously stated, many businesses have incurred excessive compliance costs because of uncertainty over what constitutes compliance with the act's accounting provisions coupled with the resulting criminal penalties. While the act's accounting provisions have been the source of much discussion and interest in the business community, SEC has not provided the regulatory guidance that business needs to comply with the act.)

In addition, companies have had three years of experience in making the judgments and estimates contemplated by the Act. Given the state of the art with respect to the making of cost-benefit judgments concerning internal accounting controls at the time the FCPA was enacted, and the fact that a certain degree of confusion was to be anticipated in implementing a new law, it is not surprising that there may have been some costs that have proved to be excessive. It should also be pointed out, however, that a large portion of the costs incurred may be in the nature of one-time start-up costs, such as those that many issuers incurred in conducting comprehensive reviews of their internal accounting control systems and taking corrective action with

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20/ See Securities Exchange Act Release No. 15772 (Apr. 30, 1979); 44 Fed. Reg. 26702 (May 4, 1979) and Securities Exchange Act Release No. 16877 (Jan. 9, 1980); 45 Fed. Reg. 40134 (June 13, 1980).

21/ See Securities Exchange Act Release No. 15570 (Feb. 15, 1979); 44 Fed. Reg. 10964 (Feb. 23, 1979) These rules are not discussed in the draft report.

(GAO COMMENTS: Our information was developed primarily from personal interviews and through our questionnaire. To obtain candid and complete responses, we did use certain procedures to assure confidentiality of our questionnaire respondents. However, as discussed on page 4 and in appendix II, our questionnaire was validated by visiting 27 companies and completing the questionnaire in person. During this visit auditors interviewed company officials and reviewed documentation considered necessary to assess the credibility of the questionnaire responses. Statistical tests indicated no differences between the validation sample and the self-administered, mailed questionnaire.)

Chapter 2: THE ACT'S IMPACT ON CORPORATE ACTIVITIES

Although Chapter 2 of the draft report reflects that the FCPA has had a substantial impact on corporate conduct, the draft does not adequately emphasize the extent to which the FCPA has been a positive force. In addition, the chapter emphasizes perceptions that the cost of complying with the accounting provisions exceed the benefits and that the Act has had an adverse impact upon U.S. overseas business, despite the survey data which indicate that these concerns may either be exaggerated or a matter of concern to a relatively small proportion of the companies surveyed. Under these circumstances, we have set forth our own analysis of the survey data below in order to assist the GAO in understanding our position.

A. The Accounting Provisions

The data compiled in response to the GAO questionaire indicates that the accounting provisions have been a success in promoting the objectives that the Congress sought to achieve in enacting those provisions. For example, 95.7% of the respondents reviewed their audit and internal accounting control functions or compared them with the requirements of the FCPA, after the statute was enacted. Moreover, 80.7% of these respondents made changes as a result of that review. 19/ These findings seem to be particularly significant in view of the fact that 64.9% of the respondents had already revised or increased their audit and internal accounting control functions, or made related changes, in the four-year period prior to enactment of the FCPA. Taken together, the findings seem to indicate that four out of five issuers found it necessary to make improvements in their audit and internal accounting control functions in order to provide reasonable assurances that the statutory objectives are met.

19/ A total of 78.6% of the respondents reported that they had increased the amount of their internal accounting control documentation to a "moderate," "great" or "very great extent." In addition, 52.5% increased routine testing of their internal accounting control systems to a "moderate," "great" or "very great extent."

D. Use of Anonymous Comments That Are Not Part of the Empirical Data Base Acquired in Response to the GAO's Questionnaire and Limited Supplemental Survey

The draft report appears to be based, in large measure, upon information derived from sources other than the responses to the questionnaire and the GAO's limited supplemental survey of leading companies in the aircraft and construction industries. To the extent the data received in response to the questionnaire is based on accepted survey and statistical sampling techniques, together with a audit of 27 of the respondents to assess the credibility of their responses, the GAO Report provides empirical data that has a credible basis. Unfortunately, this empirical data is mixed together with anonymous comments received from public accounting firms, professional accounting an auditing organizations, professional legal associations, "cognizant business and public interest groups" and certain government officials that do not have responsibility for administering or enforcing the FCPA. Because these comments are often stated in conclusory terms, it cannot always be determined what the reasons for those comments are, whether those reasons have merit or whether they may be based upon faulty premises. Moreover, the draft report tends to include negative comments from such sources without any apparent effort on the GAO's part to evaluate whether the reasons have merit, or whether the statements repeated in the draft are credible.

(GAO COMMENTS: Contrary to SEC's perception, much of the draft report data is based on the results of our questionnaire survey of the Fortune 1000--a survey that is statistically valid. (See pp. 4 to 5 and app II.) Where appropriate, we also obtained information, generally through structured interviews, from leading public accounting firms; professional accounting and auditing organizations; business associations; legal associations; and certain government officials, including officials from SEC, and Departments of Justice, Commerce, and State. In addition, we cited the pertinent results of the Financial Executives Research Foundation's comprehensive study of internal control in U.S. corporations.

In all cases, the source of the data is clearly identified. In addition, the data is not, as SEC alleges, "mixed together" but rather is used to complement and augment the results of the corporate questionnaire. It is common practice to test the validity and credibility of study findings by comparing data gathered through different survey methods and from different source groups.

We disagree with SEC's contention that our report criticizes the accounting provisions without analyzing of the merits. For example, after discussing in chapter 3 criticisms that the accounting provisions are too vague, we point out the efforts to diminish the uncertainty and address the problems remaining. Our conclusion that guidance provided by the accounting profession and SEC should alleviate some of the uncertainty should in no way reduce our message that the accounting provisions have resulted in widespread uncertainty. The SEC Chairman himself recognized this in his January

(GAO COMMENTS: We disagree with SEC's contention that the report overly emphasizes criminal liability. As SEC itself points out, the report addresses both the potential civil and criminal penalties. Although SEC has yet to make a recommendation to Justice for criminal prosecution under the act, its enforcement strategy or track record should not be used to dismiss what could face potential violators. In discussions with members of the business community, the threat of possible criminal prosecution is perceived as a real threat, not an imaginary one. Our final report recognizes the relationship of the potential criminal penalties and the inherent subjectivity and clarity problems with the accounting provisions. Therefore, we have included a recommendation to the Congress to repeal the criminal penalties associated with the act's accounting provisions. We have included SEC's enforcement record in our final report.)

Moreover, even in the context of civil injunctive actions, many of the fears reflected in the draft report with respect to the possible enforcement of the accounting provisions are misplaced. The Commission's Chairman, Harold M. Williams recently gave an address to a meeting of the American Institute of Certified Public Accountants ("AICPA"), which was entitled "The Accounting Provisions of the Foreign Corrupt Practices Act: An Analysis." 14/ In that address, he stated the Commission's policy — with the concurrence of all of the other Commissioners — concerning Commission actions to enforce the accounting provisions. After pointing out that the Commission has considered the commencement of enforcement actions "prudently and with common sense," he noted that

"the Commission has not sought out violations of the accounting provisions for their own sake; indeed, we have not chosen to bring a single case under these provisions that did not also involve other violations of law. The Commission, instead, places its greatest emphasis on encouraging an environment in which the private sector can meet its responsibilities in complying with the Act meaningfully and creatively."

Toward the end of the address, Chairman Williams indicated that the Commission's efforts have been directed toward encouraging

"public companies to develop innovative records and control systems, to modify and improve them as circumstances change, and to correct recordkeeping errors when they occur without a chilling fear of penalty or inference that a violation of the Act is involved."

Chairman Williams also pointed out that the principal objective of the accounting provisions is to prevent knowing or reckless conduct; and he alluded to the fact that the courts must find that there is a reasonable likelihood that a defendant will engage in violative conduct in the future before injunctive relief is appropriate:

14/ The address was delivered on January 13, 1981, in Washington, D.C.

of funds used for such payments or the purposes for which they were disbursed. 9/

In brief, the Commission reported that its experience in uncovering questionable and illegal payments had revealed a breakdown in the system of corporate accountability, which was a matter of concern irrespective of any bribery or questionable payments. 10/ As the Commission's Report pointed out:

> A fundamental tenet of the recordkeeping system of American companies is the notion of corporate accountability. It seems clear that investors are entitled to rely on the implicit representations that corporations will account for their funds properly and will not "launder" or otherwise channel funds out of or omit to include such funds in the accounting system so that there are no checks possible on how much of the corporation's funds are being expended or whether in fact those funds are expended in the manner management later claims. 11/

The Commission was concerned because questionable and illegal corporate payments, and the related practices associated with such payments, had "cast doubt on the integrity and reliability of the corporate books and records which are the very foundation of the disclosure system established by the federal securities laws." 12/ Accordingly, the Report stated:

> Whatever their origin, the Commission regards defects in the system of corporate accountability to be matters of serious concern. Implicit in the requirement to file accurate financial statements is the requirement that they be based on adequate and truthful books and records. The integrity of corporate books and records is essential to the entire reporting system administered by the Commission. 13/

While it is true that the accounting provisions "were intended to operate in tandem with" the bribery prohibitions of the FCPA to deter corporate bribery, the deterrence of such bribery was intended to be a result of a

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9/ Id. at 23-24.

10/ Id. at b.

11/ Id. at 58.

12/ Id. at 49-50.

13/ Id.

tailed background explanation is necessary, in our view, for a proper understanding of the issues dealt with in the draft report. There is, for example, only a single sentence concerning the reasons for enactment of the bribery provisions, which states that "the Congress perceived corporate bribery as (1) unethical, (2) unnecessary to the successful conduct of business, and (3) harmful to our relations with foreign governments." There is no attempt to provide an appreciation of the costs for the nation and American business that the Congress viewed as resulting from corporate bribery.

The legislative history reflects that a primary concern of Congress was the fact that corrupt payments to foreign officials had caused serious damage to American foreign relations in critical areas of the world. The House Report pointed out that revelations of corporate bribery "shook the Government of Japan to its political foundations and gave opponents of close ties between the United States and Japan an effective weapon with which to drive a wedge between the two nations." 1/ In addition, the House Report observed that, in Italy, alleged payments to officials of the Italian Government "eroded public support for that Government and jeopardized U.S. foreign policy, not only with respect to Italy and the Mediterranean area, but with respect to the entire NATO alliance as well." 2/ The Senate Report voiced similar concerns and noted, "The image of American democracy abroad has been tarnished." 3/

The Congress also determined that bribery of foreign officials could seriously injure the long-range interests of American business. For example, the Senate Report on the FCPA concluded that "[c]orporate bribery of foreign officials * * * affects the very stability of overseas business," and is a practice that "is fundamentally destructive" of the basic tenet of our free market system — the principle that competition for sales "should take place on the basis of price, quality and service." 4/ The House Report expressed similar concerns. Moreover, with respect to the direct costs that American businesses might incur as a result of bribery of foreign officials, the House Report added that the exposure of corporate bribery can damage a company's image, lead to costly lawsuits, cause the cancellation of contracts and result in the expropriation of valuable overseas assets. 5/ These costs are often overlooked in discussions of the bribery prohibitions.

1/ H.R. Rep. 95-640, 95th Cong., 1st Sess. 5 (1977).

2/ _Id_.

3/ _See_ S. Rep. No. 95-114, 95th Cong., 1st Sess. 3 (1977).

4/ H.R. Rep. No. 95-640, _supra_ at 4-5.

5/ _Id_.

 APPENDIX IV

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D C 20549

OFFICE OF THE
GENERAL COUNSEL

January 23, 1981

MEMORANDUM

TO: D. L. Scantlebury
The General Accounting Office

FROM: Ralph Ferrara, General Counsel
The Securities and Exchange Commission

(GAO note : Page numbers in this appendix refer to the draft report and may not correspond to this final report.)

INTRODUCTION

The Securities and Exchange Commission has authorized me to transmit to you its views with respect to the draft report of the General Accounting Office ("GAO") concerning the implementation and impact of the Foreign Corrupt Practices Act ("FCPA"). We respectfully request that you transmit this memorandum together with your report to the Congress.

The completion of the GAO study is an important event. The GAO's survey of 250 industrial corporations establishes an empirical data base which provides information that will assist the Commission, the Justice Department and the Congress in assessing the impact and implementation of the FCPA. As a result, the GAO's report constitutes a significant contribution to discussions concerning the impact and meaning of the Act.

We realize there is a widespread perception that the FCPA is causing difficulties for American business. To the extent that companies no longer may pay bribes to foreign officials in order to obtain or retain business, or hide such payments in "off-the-books" slush funds, these results are among the principal intended purposes of the Act. To the extent that there may be other problems that are unintended, however, the Commission agrees that they should be remedied so that businessmen who wish to conduct their business in accordance with the requirements of the Act can comply with the law without encountering undue burdens. What is striking about the data on which the draft report is based is the fact that the empirical evidence does not support the widespread perceptions of difficulties. If the data are reliable (and there may be some questions as to that), the rhetoric concerning ambiguities and difficulties does not appear consistent with the reality. As a result, the controversy surrounding the FCPA may well be a case in which conventional wisdom lacks a basis in hard fact. Nevertheless, the Commission wishes to make clear that it stands ready to support reasonable proposals for assisting the business community, in a manner consistent with the intended purposes of the law, in complying with the requirements of the Act.

Although new legislation often has rough edges that can only be polished by the forces of time and practical experience, the results of the GAO survey are quite positive. The survey data indicates that the FCPA has been a remarkable success and that many companies felt it necessary, in light of

if selected, were screened from the sample. Projections based on the proportion of cases screened from the sample show the actual or effective size of the universe to be 942 cases. The survey was based on 185, or 75 percent, of the 247 sample cases that had answered the questionnaire after two followup contacts.

CALCULATING THE NONRESPONSE RATE AND SAMPLING ERROR

For the companies that returned the questionnaire, the average question or item nonresponse rate estimate was 3.4 percent ± 0.7 percent at the 95-percent confidence of interval. The item nonresponse rate ranged from 0 to 23 percent. The highest nonresponse rate was observed in question 15, which we asked corporations to provide detailed information on events that occurred 7 years ago. To account for this and the fact that we stratified the sample for analysis purposes, we adjusted the size of this sample from 185 to 177. Calculations based on the sample and universe adjustments show the effective or actual sampling error to be ± 7.4 percent at the 95-percent level of confidence.

Statistical comparison between the respondent and nonrespondent groups showed that neither size nor type of industry was a factor in not responding. We did not try to further survey the nonrespondent population (25 percent) beyond two followup contacts.

We believe that the results of this study can be projected to the entire population. However, if one were to take the most conservative position and limit the projections to the 75 percent of the population that responded, the effective sampling error would decrease to ± 4 percent.

TECHNICAL DESCRIPTION OF GAO'S SURVEY AND SAMPLING METHODOLOGY

This appendix contains a detailed technical description of our survey and sampling procedures, augmenting the summary description in chapter 1. It covers pretesting of the questionnaire, selection of the sample, validation of the questionnaire results, calculation of the effective universe and sample size, and calculation of the nonresponse rate and sampling error.

PRETESTING THE QUESTIONNAIRE

Before its use, the questionnaire was tested at five New York area corporations selected at random from the study sample. In the first phase of the pretest, the corporate officials completed the questionnaire as if they had received it in the mail. A GAO observer noted unobtrusively the time it took to complete each question as well as any difficulties experienced. During the second phase, a standardized procedure was used to elicit the corporate officials' descriptions of the various difficulties and considerations encountered as they completed each item.

In addition to the pretest, a consultant, who is a nationally recognized expert in the area covered by our survey, reviewed the questionnaire.

Based on the results of the pretest and the consultant's review, we revised the questionnaire so that all questions were (1) relevant, (2) easy to understand, and (3) relatively free of design flaws that could introduce bias or error into the study results.

The responses to the questionnaire obtained during the pretest were not included in our final report. However, the pretest responses do support the overall questionnaire results.

SELECTING THE SAMPLE

The sample was drawn as a stratified random sample from a list of the first and second 500 largest industrials in America. Each strata contained 125 companies. Forty companies were selected at random from the sample for the validation study. The validation process did not affect the questionnaire reporting; hence the validation cases were not excluded from the initial sample of 250 cases. Thirteen appropriate selections were screened out of the sample and replaced with another random selection, and the sample universe adjusted accordingly. Three inappropriate cases which had inadvertently passed through the initial screening were deleted later. These were not replaced because the study was well underway; hence the final sample was 247. The screening excluded companies that had gone bankrupt or merged or had been taken over or were no longer publicly owned. It also excluded those corporations that had expressed policies

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37. Consider the requirements listed below as they are described in the Foreign Corrupt Practices Act. Rate each particular requirements description as to the adequacy with which you feel the text clearly explains what is expected from your company in order to be in compliance. (*Check one column for each row.*)

	More than adequate (1)	Adequate (2)	Of marginal adequacy (3)	Inadequate (4)	Very inadequate (5)
1. The maintenance of accurate books and records	% 4.6	45.7	13.7	16.0	20.0
2. The maintenance of a sufficient system of internal accounting controls	2.3	30.5	20.1	21.8	25.3
3. The provision of reasonable assurance	0.6	24.6	19.3	23.4	32.2
4. The issue of materiality		13.9	9.2	22.0	54.9
5. The prohibitions against foreign bribery	11.1	68.4	11.7	5.3	3.5
6. Facilitating payments	3.5	55.0	22.2	10.5	8.8
7. Questionable payment by foreign subsidiaries	6.5	51.8	18.2	14.1	9.4
8. Your company's responsibility for actions of foreign agents	4.8	40.5	17.9	20.8	% 16.1
9. Contribution to foreign political parties	7.6	67.8	15.2	4.1	% 5.3

38. If you checked marginal or inadequate for any of the above requirements listed in question 37, please comment on the needed clarification changes. Attach an additional sheet if you need more space. ______

38. (Continued: Comments on needed clarification.)

39. Do your company's policies prohibit facilitating payments ("grease payments")?

1. ☐ Yes 49.4%
2. ☐ No 50.6

40. If yes, was this prohibition issued because of the Foreign Corrupt Practices Act antibribery provision?

1. ☐ Yes 18.0
2. ☐ No 82.0

41. Without the use of questionable payments, can American companies effectively compete against others abroad who are bribing? Assume that all other conditions are similar (*Check one.*)

1. ☐ Yes 2.8
2. ☐ Probably yes 11.2
3. ☐ Undecided 23.5
4. ☐ Probably no 40.2
5. ☐ No 22.3%

42. If no or probably no, please list some of the major industries which might be affected?

26. Were your audit and control functions, staffing procedures, or documentation revised or increased during the 4-year period prior to the enactment of the Foreign Corrupt Practices Act in December 1977?

1. ☐ Yes (continue) 64.1%
2. ☐ No (go to 28) 35.9

27. If yes, to what extent, if at all, have you made the following changes? (*Check one column for each row*)

	To little or no extent (1)	To some extent (2)	To a moderate extent (3)	To a great extent (4)	To a very great extent (5)	No basis for judgment (6)
1. More clearly specified the division and echelon responsible for maintaining an adequate accounting and control system	% 36.8	26.3	20.2	13.2	3.5	
2 Increased the number of special review audits or investigations	27.4	22.1	27.4	15.9	7.1	
3 Increased the routine testing of accounting or control systems	18.8	22.3	32.1	20.5	6.3	
4. Increased the amount of internal accounting control documentation	27.0	27.0	25.2	13.9	7.0	
5 Increased the auditing of payments to foreign agents	48.5	19.6	17.5	10.3	4.1	
6 Increased the size of the internal audit staff	14.9	23.7	30.7	15.8	14.9	
7. Increased the responsibility of the internal audit staff	24.1	28.6	18.8	17.9	10.7	
8 Increased the training of the internal audit staff	30.3	26.6	20.2	15.6	7.3	
9 Increased the independence from management of the internal audit staff	53.7	22.2	10.2	12.0	1.9	
10 Increased the independence from management of the Board of Directors or its Audit Committee	64.8	8.3	8.3	12.0	6.5	
11. Increased the number of Audit Committee members who are independent of management	69.4	6.5	3.7	7.4	13.0	
12 Increased the size of the Audit Committee	73.1	2.8	3.7	6.5	% 13.9	

III. THE FOREIGN CORRUPT PRACTICES ACT AND THE BURDEN OF COMPLIANCE

28. Your company's efforts to comply with the Foreign Corrupt Practices Act may have resulted in changes to your management and accountability systems which, in the long run, will benefit your company. However, there may have been other cost burdens associated with your compliance efforts which did not yield such benefits. The question is: Did your compliance efforts result in costs that were greater than the value of the benefit received?

1. ☐ Yes (continue) 56.4
2. ☐ No (go to 30) 43.6%

15. Again, if yes to 13, and if applicable, what was the nature of these changes (e.g., new policies were issued to cover a type of violation that had not been previously addressed, more people were required to acknowledge in writing, stricter codes of discipline were applied, etc.)? (*Check all that apply.*)

1. ☐ Policies were rewritten to be more specific or to expand scope 78.0%
2. ☐ Policies were issued to cover type(s) of violation that had not been previously addressed 63.4
3. ☐ More people were informed 67.1
4. ☐ People were informed more often 42.7
5. ☐ People were required to acknowledge in writing more often 57.3
6. ☐ Procedures for communicating policies were made more formal 58.5
7. ☐ More attention was given to the procedures for informing people 46.3
8. ☐ More effort was put into the development and use of visual aids, presentations, and media material for communicating policies 13.4
9. ☐ More severe disciplinary measures were adopted for code violations 12.2
10. ☐ Other (*specify*) ____ 4.9

II. THE FOREIGN CORRUPT PRACTICES ACT AND YOUR AUDIT OR CONTROL PROCEDURES

16. Since the passage of the Foreign Corrupt Practices Act, has your corporation conducted special reviews to identify areas or situations where each of the following types of policy violations are likely to occur? Note: "Special reviews" are reviews conducted in addition to normal internal audit coverage. (*Check one column for each row.*)

	Not applicable no policy (1)	Yes (2)	No (3)
1. Questionable or improper foreign payments		63.4%	36.6
2. Domestic or foreign bribes		60.1	39.9
3 Giving expensive gifts		44.6	55.4
4. Using corporate funds for political contributions		48.8	51.2
5. Misuse or mismanagement of cash pools or funds		50.6	49.4
6. Failing to record financial transactions		49.4	50.6
7. Failing to secure proper authorizations for transactions		54.2	45.8
8. Failing to assure for the security of all company assets		47.5	52.5
9 Failing to assure for the proper utilization of all company assets		49.0	51.0
10. Making false entries on company books or records		51.2	48.8%

17. Does your company have a program for routinely testing the adequacy of your internal accounting control system?

1. ☐ Yes 96.2%
2. ☐ No 3.8

18. Does your company's annual report cite management's responsibility for preparing financial statements and does it describe the system of internal accounting controls? (*Check yes or no for each statement.*)

	Yes	No
1. Report cites management's responsibility for financial statements	27.2	72.8
2. Report describes system for internal accounting controls	16.8	83.2%

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6. How does your management communicate your corporate policies on questionable practices, improprieties, etc., in the use of corporate funds and transaction reporting? (*Check all that apply.*)

1. ☐	Required as part of the orientation procedure	33.3%
2. ☐	Briefings or presentations	43.0
3 ☐	Memos or notices	86.7
4. ☐	Other (*specify*)________________	31.5

7 Does your management use prepared media material to assist in these communications (e.g., films, pamphlets, etc.)?

1. ☐	Yes (**continue**)	45.1
2. ☐	No (**go to 9**)	55.0

8 If yes, which type(s) of media materials are used? (*Check all that apply.*)

1. ☐	Films	9.5
2. ☐	Viewgraphs or slides	21.6
3 ☐	Flipcharts	8.1
4 ☐	Pamphlets, flyers, booklets, handouts, or newsletters	86.5
5. ☐	Other (*specify*)________________	9.5

9. Were your corporate policies or codes of conduct covering questionable practices, improprieties, etc., reviewed or compared with the provisions and requirements of the Foreign Corrupt Practices Act of 1977?

1. ☐	Yes (**continue**)	98.2
2. ☐	No (**go to 13**)	1.8

10. If yes, did this review influence any changes or revisions in your codes of conduct or relevant policies? Include changes in code or policy documentation and communication procedures.

1. ☐	Yes (**continue**)	63.4
2. ☐	No (**go to 13**)	36.6%

11. If yes to 10, what policy areas were changed and how extensive were these changes? (*Check columns showing the area and extent of the change.*)

	Minor changes were made	Important changes were made
	1	
1. Questionable or improper foreign payments	59.4%	40.6
2. Domestic or foreign bribes	64.6	35.4
3. Giving expensive gifts	81.4	18.6
4. Using corporate funds for political contributions	74.0	26.0
5. Misuse or mismanagement of cash pools or funds	54.8	45.2
6 Failing to record financial transactions	44.4	55.6
7. Failing to secure proper authorizations for transactions	50.0	50.0
8. Failing to assure for the security of all company assets	52.9	47.1
9. Failing to assure for the proper utilization of all company assets	53.7	46.3
10 Making false entries on company books or records	52.5	47.5%

APPENDIX I

U.S. GENERAL ACCOUNTING OFFICE

SURVEY OF THE IMPACT ON BUSINESS OF THE FOREIGN CORRUPT PRACTICES ACT OF 1977

INSTRUCTIONS

The purpose of this questionnaire is to assess the impact the Foreign Corrupt Practices Act has on the business community This law, enacted in December 1977, deals with overseas payments and the sufficiency and accuracy of accounting records and controls. This survey is being conducted by the U.S. General Accounting Office, which is responsible for the congressional oversight of all Federal expenditures and regulatory activities. Specifically we need the following information What effect has this Act had on your codes of conduct, accounting controls, and corporate oversight? What cost burdens, if any, did your company experience in complying with this Act? What impact has this Act had on the competitive position of your company and other American companies? And what requirements of this Act, if any, need to be changed?

If the right consultation is available, the form can be completed in about half an hour Most of the questions can be quickly answered either by checking boxes or by filling in blanks. A few questions may require a short written answer. We do not expect you to have to spend much time consulting records or working up figures. The questionnaire should be answered by the Chairman of the Board or his designee. However, the Chairman may wish to consult key staff familiar with the company's audit practices, codes of conduct, and personnel procedures, as well as someone familiar with the company's overseas business.

To encourage frank and honest responses we have taken the following steps. First, you were chosen as part of a sample of 250 selected at random from a list of the Nation's 1,000 largest industrial corporations. Second, the questionnaire is anonymous. There is nothing in this form that can identify how you or any other company responded. We ask only that you mail back a postcard indicating that you have completed your questionnaire. We need these cards returned so we can remind those who do not answer We are asking for your help; this is not a requirement.

Complete the questionnaire and mail it back in the self-addressed, stamped envelope within 10 days after receiving this request. Also, do not forget to mail back the enclosed postcard telling us that you have completed your questionnaire. Do not return the card in the envelope with the questionnaire. This card goes to a different address and no one can associate the number on the card with your questionnaire.

If you have any questions please call either Tom Bittman in New York at (212) 264-0742 or Ed Messinger at GAO Headquarters in Washington, D.C. at (202) 376-3023 They will be standing by to provide assistance. Please help us. We can not assess the impact of this Act and report your views and experiences to the Congress unless we hear from you.

Thank you for your consideration.

D L. Scantlebury
Director, Financial and General
Management Studies Division

I THE FOREIGN CORRUPT PRACTICES ACT AND YOUR CORPORATE POLICIES

1 Does your company have written policies or codes of conduct covering any of the following: questionable practices, improprieties, or negligence in the use of corporate funds and/or the responsibilities for complete and accurate transaction reporting?

1 ☐ Yes **(go to 3)** 89.2%

2 ☐ No **(answer 2, then go to 16)** 10.8

2. If no, how do you provide guidance to your employees in these areas? *(Write your answer in the space below)*

____

____

____

____

3 Which of the following types of conduct are addressed by these policies? *(Check all that apply)*

1. ☐	Questionable or improper foreign payments	93.9
2. ☐	Domestic or foreign bribes	93.4
3 ☐	Giving expensive gifts	86.7
4 ☐	Using corporate funds for political contributions	95.8
5 ☐	Misuse or mismanagement of cash pools or funds	83.0
6 ☐	Failing to record financial transactions	90.9
7. ☐	Failing to secure proper authorizations for transactions	83.0
8. ☐	Failing to assure for the security of all company assets	79.4
9 ☐	Failing to assure for the proper utilization of all company assets	72.1
10 ☐	Making false entries on company books or records	89.7%

virtually the entire period. For example, in September 1978, only 9 months after the act's passage, President Carter indicated that he was hopeful business would not forgo legitimate export opportunities because of uncertainty about the application of the act.

To address this uncertainty, the President directed Justice to provide the business community with guidance concerning its enforcement intentions under the act. Unfortunately, the Justice review program was not implemented until almost 18 months after the Presidential directive. This review program has been criticized by some government agencies and members of the business community as inadequate. Although our survey results show that serious ambiguities exist, only five companies have used the review procedure since its inception in March 1980. Further, only five parties--four of which specifically addressed the review program--responded to a request for public comment on the effectiveness of the review procedures. The four addressing the review procedure were highly critical of the program.

Because the Justice program has not effectively addressed the uncertainty over what constitutes compliance with the antibribery provisions, alternative ways of addressing the ambiguities should be developed. Because of the shared enforcement responsibility, the formulation of any additional guidance should be a joint Justice-SEC responsibility.

Also, a strong international agreement is needed. Although progress in this area has been slow, at least some type of international antibribery ban among the United States and its principal economic industrial allies may be possible in the near future. The United States should continue to take the lead in this effort.

RECOMMENDATIONS TO THE CONGRESS

We recommend that the Congress closely monitor the status of U.S. efforts to reach an international antibribery agreement and that the Congress urge the President to actively pursue such an agreement.

RECOMMENDATIONS TO THE DEPARTMENT OF JUSTICE AND SEC

We recommend that the Attorney General and the Chairman of SEC, with input from the Departments of Commerce and State, the U.S. Trade Representative, and the business community develop alternatives to address the antibribery ambiguities. Because the issues are complex, we are offering the following options.

I. Provide additional guidance to the business community through the use of hypothetical situations

Under this option, guidance would be provided on the antibribery provisions through the use of hypothetical situations. This method has been recommended by some Government agencies and corporate officials as the preferable way to provide guidance to the business community. We believe that Justice, jointly with SEC and with input from others, including Departments of Commerce and State, the U.S. Trade Representative, and the business community, should be able to prepare hypothetical cases. Both Justice and SEC should be bound by any such guidance.

and/or

II. Offer legislative proposals to reduce the ambiguities

Under this option, the Justice Department, SEC, and other interested agencies would offer legislative proposals which would amend the act to more explicitly define the antibribery provisions and could cover concepts such as

were similar, American companies could not successfully compete abroad against foreign competitors that were bribing. Recent news articles indicate that some foreign competitors are bribing foreign officials--in some cases, blatantly.

International attempts to ban bribery have been in progress since August 1976, when the United Nations Economic and Social Council adopted a resolution calling for a working group of representatives from 18 nations to draft an international treaty on illicit payments. State Department officials told us that the council's work group developed a draft agreement in the spring of 1979. They noted, however, that the United Nations General Assembly has failed to adopt any agreement on illicit payments. These officials said that resolution of the U.N. agreement is hindered by the fact that G-77 nations of the United Nations believe the illicit payments agreement should be coupled with an international code of conduct.

At a June 1980 economic summit in Venice, seven industrial nations--including the United States--reaffirmed support for the U.N. effort but decided to undertake independent action if U.N. efforts were delayed. According to State Department officials, the United States has made a good faith effort to obtain an U. N. agreement since the economic summit, but a compromise on the linkage factor could not be worked out. Current plans call for the United States to proceed with obtaining an agreement in accord with the decision reached at the Venice economic summit. The State Department is not optimistic that an effective agreement can be put into effect in the near future.

LEGISLATION IS BEING CONSIDERED TO CLARIFY THE ANTIBRIBERY PROVISIONS

Bills (H.R. 7479 and S.2763) to amend the antibribery provisions were introduced during the last session of Congress and we anticipate that they will be reintroduced in the near future. Supporters of these proposals believe that the act has caused unnecessary confusion for business as to the scope of legitimate overseas business activities.

The bills would eliminate SEC's authority to enforce the antibribery provisions and give this responsibility solely to Justice. The bill would also require Justice to issue compliance guidelines that would describe specific types of conduct that it considers to be in compliance with the act, as well as precautionary procedures that would insure compliance.

Justice would also be required to establish a review procedure for responding to specific inquiries about whether proposed actions or transactions would be in compliance with the

"We do not have guidelines for rapists, muggers and embezzlers, and I do not think we need guidelines for corporations who want to bribe foreign officials."

However, reports accompanying Senate and House versions of the act recognized the necessity of close cooperation between SEC and Justice in deciding whether enforcement action would be taken. For example, the House report stated that traditionally there has been a close working relationship between Justice and SEC and it fully expects such cooperation will continue in enforcing the act.

Also, participation with Justice would have been consistent with SEC's current policy of issuing administrative interpretations of laws and regulations when requested by interested parties. In 1979, SEC issued over 2,000 interpretative letters as a result of public requests. Their purpose was to help resolve legal questions as they related to a specific set of facts so that individuals would be aided in complying with securities laws.

On August 28, 1980, SEC announced that it would accept Justice's statement of enforcement intention for contemplated transactions under the act. SEC was faced with continuing criticism of its decision not to participate and, as discussed on page 46, was also faced with possible congressional action to eliminate its role in antibribery enforcement. Also, SEC recognized that it would be difficult to take enforcement action in cases when Justice had told a company that it would not take action.

Although still not participating in the formulation of Justice's advance rulings, SEC stated that it would not prosecute corporations for transactions that had received Justice clearance before May 31, 1981. However, SEC has reserved the right to independently determine the need for enforcement action irrespective of Justice's guidance. SEC said that its new position is effective until May 31, 1981, at which time it will evaluate the experience of the Justice program. It will then decide whether to continue its present policy, directly participate with Justice in the program, or take some other action.

In December 1980, the President's Export Council made recommendations which addressed both the Justice review procedures and the antibribery provisions. The Council was directed by the President to serve as a national advisory body on matters relating to the U.S. export trade. In its report to the President, the Council cited the results of the September 1980 export report prepared by Commerce and the Office of the U.S. Trade Representative, including the business community's criticisms of the review program. The report then made the following recommendations:

the business review procedure used by Justice's Antitrust Division.

The review procedure requires that a top company official submit to Justice a detailed statement of all facts material to a prospective transaction in a foreign country. Before the transaction, Justice advises the company whether it would take enforcement action under the act if the company proceeded with the action. Justice attempts to respond within 30 days. Justice officials believe that with an advanced ruling, the companies will be in a position to decide whether to proceed, and uncertainty about the act's application to the transaction should be resolved.

Under the procedure, the enforcement intent is stated only with regard to the act's antibribery provisions. The procedure is not available for matters related to the accounting provisions. Also, Justice's statement of enforcement intention is binding only for the company submitting the request and only if underlying facts remain unchanged. Only Justice is bound by the review statement.

The Attorney General has agreed to prevent public disclosure of confidential business information to the maximum extent possible. However, to provide guidance to the business and legal communities, Justice's decision in each matter will be contained in a public release which will generally describe the nature of the transaction and Justice's enforcement decision.

In addition, Justice has issued a statement of its enforcement priorities, identifying a number of factors that will increase the likelihood of investigation or prosecution under the antibribery provisions. For example, the probability of a Justice enforcement action is greater if the prohibited payment is made in a country where the only competitors are American companies or where the payments are made to a foreign cabinet officer or other official of high rank.

Will the program reduce uncertainty?

The program has not been effective in addressing the uncertainty caused by the act's ambiguities. Since it began in March 1980, the program faced an uphill struggle. As of January 1981, only five companies had requested reviews.

The program's format has been criticized. Officials of the Treasury and State Departments recommended that Justice issue guidelines through the use of hypothetical situations rather than ruling on a case-by-case basis. The use of hypothetical cases had been previously recommended by the Department of Commerce but rejected by Justice because Justice felt it lacked the experience needed to formulate such cases.

This definition has been criticized as unclear. Lawyers we contacted questioned whether employees of public corporations, such as national airlines or nationalized companies, are considered foreign officials. Similar questions have surfaced in countries--particularly developing countries--where there are small and frequently closely related groups, including both business and government relationships as well as families. Individuals within these groups frequently move between the private and public sectors, often without a clear distinction.

Corrupt payments

The act's requirement that a payment must be made "corruptly" to violate the act has also caused uncertainty. Some critics emphasize that it is difficult to distinguish between corrupt payments and routine entertainment and business gifts. For example, does the act prohibit companies from furnishing foreign officials with meals, transportation, entertainment, and promotional gifts in connection with selling their products? Critics charge that without a better definition, determining compliance becomes subjective, causing uncertainty.

The previously cited September 1980 report on exports indicated that, aside from facilitating payments, there is no specific exception for entertainment or gifts. The report stated that since the act's standard of something of value could encompass lunch, theater tickets, and the like, businessmen are uncertain whether these expenditures are permissible. In addition, the report stated that businessmen are uncertain about the extent to which the laws and social customs of the host country will be taken into account in determining whether a gift was given or entertainment was provided.

Facilitating payments

According to the act's legislative history, facilitating payments are allowed to expedite action from government employees whose duties are essentially ministerial or clerical. However, as pointed out by one trade association, what is "ministerial or clerical" to one person may not be to another. Uncertainty as to the meaning of "facilitating payments" was confirmed by our questionnaire respondents. About 38 percent rated the clarity of this provision as ranging from marginally inadequate to very inadequate. Again, companies who reported the act had decreased their overseas business were much more critical of the provision's clarity. Over 30 percent of these respondents rated the clarity of this provision as inadequate or very inadequate, with another 25 percent rating the clarity as only marginally adequate.

The September 1980 report on exports also indicated that businessmen are uncertain about facilitating payments. It stated that the act's language raises the question of whether a large corrupt payment to an official with ministerial duties is not

The act also prohibits the offering or paying of anything of value to any person, such as a foreign affiliate or an agent, if it is known or if there is reason to know that all or part of the payment will be used for prohibited actions. The act does not prohibit facilitating payments. These payments--commonly called "grease" payments--are made to merely move a matter or decision not involving discretionary action. An example is a payment made to expedite the processing of a customs document.

ANTIBRIBERY PROVISIONS HAVE BEEN CRITICIZED AS UNCLEAR

Corporate and governmental officials have criticized the antibribery provisions as being ambiguous about what constitutes compliance. In particular, the clarity of the antibribery provisions have been severely criticized by those questionnaire respondents who reported that the act has decreased their overseas business. Of the more than 30 percent of our respondents who reported that the act caused a decrease in their overseas business, approximately 70 percent rated the clarity of at least one of the antibribery provisions as inadequate or very inadequate. A general perception exists that because of these ambiguities, American companies may have forgone legitimate business opportunities.

The ambiguities include confusion or uncertainty about:

--The degree of responsibility a company has for the actions of its foreign agents and affiliates (the "reason to know" provision).

--The definition of "foreign official."

--Whether a payment will be considered corrupt.

--Whether a payment to a foreign official is a bribe (illegal under the act) or a facilitating payment (allowed under the act.)

--Whether payments made in response to economic extortion are bribes.

"Reason to know" provision

How does a company comply with the provision prohibiting payments to a person if there is "reason to know" that these payments will be used to bribe foreign officials? About 50 percent of our questionnaire respondents rated the clarity of the provisions as ranging from marginally inadequate to very inadequate. The clarity of the "reason to know" provision was of particular concern to the respondents who reported that the act had decreased their overseas business with over 50 percent rating the clarity as inadequate or very inadequate, and an additional 18 percent rating the clarity as only marginally adequate. Some

AGENCY COMMENTS AND OUR EVALUATION

SEC acknowledged that certain of the concerns raised in our report have some merit. It welcomed the completion of our study and said our report assisted in clarifying its own views in light of the questionnaire results. As discussed previously, the SEC Chairman on January 13, 1981--about 5 weeks after receiving our draft report--made a policy statement on compliance with the act's accounting provisions.

SEC said that our recommendation calling for additional guidance on compliance with the accounting provisions appeared to be made within the framework of the law, but was not sure what exactly was intended by our recommendation. It perceived that we were recommending an arithmetical standard that in its view could be too rigid and inflexible to provide for proper management judgment and may be inconsistent with the intent of the act. SEC also commented extensively on the accounting provisions in general and on compliance with the act raising certain questions about our report.

SEC comments together with our evaluation are included in appendix IV. To insure that our position is understood and in light of the SEC Chairman's January 13, 1981, policy statement, we have clarified our final report to recommend that SEC provide guidance to business on the factors and criteria that will be taken into account in assessing reasonableness. In addition, we are also recommending that the Congress repeal criminal penalties associated with the act's accounting provisions. SEC did not comment on this recommendation since it was not included in our draft report.

Liability under the bills' accounting provisions would be limited to (1) knowing falsification of company books and records and (2) intentional attempts to circumvent the internal accounting controls. The present act may make an issuer liable if its books are not kept properly, irrespective of intent or knowledge.

We share the concern of the bills' sponsors that without guidance on the factors and criteria that will be considered in assessing reasonableness, business may incur unreasonable compliance costs under the act's accounting provisions. However, application of the traditional standard of materiality called for in these bills and by the business community could weaken the present intent of the accounting provisions to enhance corporate accountability over assets. Also, in tying materiality to intent, the bills provide that knowing falsification of company books and records involving an immaterial amount in relation to a company's financial statements would be permissible. For a large company, such transactions could involve millions of dollars.

As discussed on page 30, given the present intent of the act's accounting provisions, the adoption of the traditional standard of materiality would, in our view, change the act's intent. This presents a complex policy issue which the Congress should carefully consider.

CONCLUSIONS

Charges that the act's accounting provisions are too vague about what constitutes compliance have been numerous. Compounding this is the controversy over whether the provisions should include a materiality standard. The uncertainty of what constitutes compliance should be diminished by guidance from the accounting profession and SEC. However, given the subjectivity inherent in the act's requirements and the virtual impossibility of developing guidelines on accounting and internal controls that can be used across the board for all companies, an element of subjectivity will always remain.

SEC needs to provide further guidance to business on the factors and criteria that will be considered in assessing compliance with the act's accounting provisions so that companies can avoid unnecessary compliance costs. However, as discussed previously, the traditional standard of materiality related to financial disclosure is too broad given the congressional intent of the act's accounting provisions to improve corporate accountability over assets. Instead, SEC should elicit the views and work closely with the corporate community and the accounting profession in determining what additional guidance is needed and in determining the format of the guidance.

The accounting provisions call for management judgment covering diverse and oftentimes complex recordkeeping and internal control systems. The provisions, even with additional guidance from SEC on compliance, will, by their nature, still require highly

provisions were designed to operate as a preventive measure--to prevent the use of corporate assets for corrupt purposes. Subjecting corporate management to potential criminal penalties for noncompliance with essentially a preventive measure could be counterproductive. We believe that the Congress should repeal the criminal sanctions associated with the accounting provisions to insure that business can work toward compliance in a cost-effective and not a defensive manner.

As discussed previously, the legislative history calls for management judgment covering diverse and oftentimes complex recordkeeping and internal control systems. These are highy subjective determinations, even with the additional guidance we call for SEC to develop. The Congress made clear that it saw the establishment and maintenance of systems of internal control and accurate books and records, which are interrelated, as a fundamental responsibility of management. It adopted current accounting literature, in particular the AICPA's Statement on Auditing Standards, No. 1, and called for the accounting profession to use its professional judgment in evaluating the systems of internal control maintained by companies.

However, as discussed previously, the AICPA developed the standards in Statement on Auditing Standards, No. 1 to provide broad professional guidance in the independent auditor's study and evaluation of internal accounting control. The auditor's evaluation is made for the limited purpose of serving as a basis for setting the scope of the examination of financial statements. Further, the SEC has held that the act does not adopt a materiality standard--a standard recognized by the accounting profession and included in Statement on Auditing Standards, No. 1. Instead, as discussed previously, a reasonableness standard--a concept not well defined for recordkeeping and internal control systems--is used. This standard requires management to estimate the cost-benefits of any steps to comply with the accounting provisions. However, as also discussed previously, cost-benefit analysis is not a precise science and it is rare that an objective measure, particularly benefits, can be made. Business is, therefore, faced with a dilemma--how far does it go in instituting controls? Our review shows that business perceives that it has incurred unnecessary compliance costs, in part, we believe, because of the fear of criminal reprisals for minor irregularities of internal control weaknesses.

Naturally, the possibility of criminal prosecution can be unsettling for even the most confident and law-abiding corporate executive. In his January 13, 1981, speech, the SEC Chairman points out that the anxieties created by the act--among men and women of utmost good faith--have been, in his experience, without equal. The Chairman acknowledged that this consternation can be attributed, in significant part, to the spectre which some commentators have raised of exposure to SEC enforcement action,

history emphasizes that management must observe a standard of reasonableness in complying with the act's accounting provisions.

There is uncertainty and disagreement, however, over what is meant by a "reasonableness" standard. For example, the ABA committee guide implies that a company would exercise reasonable care if it complied with the accounting provisions in all material aspects. However, as previously mentioned, SEC, the agency that will enforce the provisions, disagrees and emphasizes that a reasonableness standard governs.

We believe that application of the traditional standard of materiality could weaken the intent of the accounting provisions to enhance corporate accountability over assets. As discussed on page 25, the traditional standard of materiality is geared to determine what information should be disclosed to investors. The application of the traditional standard of materiality would create a minimum threshold that would allow major deficiencies in accountability to occur. This could create problems since for many large companies the minimum threshold--below which errors and intentional acts would be allowed--would be quite high.

In addition, the standard of materiality is not appropriate to standards or thresholds used by management, even before the act, to assess the adequacy of internal accounting control systems. For example, depending on the value of a company's assets, a $1 million travel expense fraud may not be material in relation to a company's financial statements but may be material in relation to travel expenses and management's control over them.

For these reasons, we believe that SEC should provide guidance to the business community on the factors and criteria that will be considered in assessing the reasonableness of companies' compliance efforts. As discussed previously, the legislative history of the act provides for flexibility and management judgment and looks to the accounting profession to use its professional judgment in evaluating companies' systems of internal controls. Therefore, SEC must elicit the views and work closely with the business community and accounting profession in determining what additional guidance is needed and in determining the format of that guidance.

The SEC Chairman's January 13, 1981, policy statement provided some guidance regarding compliance with the accounting provisions. Although this was an important first step in addressing the concerns of the business community, we do not believe it goes far enough in providing guidance. SEC should specify the characteristics that it will apply in assessing compliance. Some qualitative characteristics were covered in

In a June 1980 release, SEC commented that the internal accounting control provision requires "reasonable assurances" that internal control objectives are met without regard to the traditional standard of materiality. SEC said that the concept of "reasonable," as opposed to "absolute," assurance recognizes that the cost of internal accounting control should not exceed the benefits received. SEC also recognized that benefits, and in many cases costs, are not likely to be precisely quantifiable and that many decisions on reasonable assurance will necessarily depend in part on estimates and judgments by management which are reasonable under the circumstances.

In the previously mentioned January 13, 1981, policy statement, the SEC Chairman said that materiality, while appropriate as a threshold standard to determine the necessity for disclosure to investors, is totally inadequate as a standard for an internal control system. He added that it is too narrow and thus too insensitive an index and that procedures designed only to uncover deficiencies in amounts material for financial statement purposes would be useless for internal control purposes. He further stated that systems that tolerate omissions or errors of many thousands or even millions of dollars would not represent, by an accepted standard, adequate records and controls. The Chairman stated that reasonableness, rather than materiality, is the appropriate test and allows flexibility in responding to particular facts and circumstances.

<u>Should the accounting provisions contain a materiality standard?</u>

One of the most important questions facing the Congress about the act is whether it should be amended to expressly include a materiality standard. It is widely held in the business community that one is needed. Corporate and accounting officials emphasized that the cost of complying with the provisions is unreasonable without a materiality standard.

We believe the traditional standard of materiality related to financial disclosure is inappropriate given the intent of the act. Instead, SEC should provide further guidance to business on the factors and criteria that should be considered in assessing reasonableness so that companies can avoid unnecessary compliance costs.

<u>The business community believes a materiality standard is needed</u>

Over 70 percent of our questionnaire respondents reported that the issue of materiality is inadequately explained in the act. For instance, respondents reported that although SEC has maintained that materiality is not a factor with regard to the

An AICPA committee studying auditors' responsibilities concluded that materiality in accounting is essentially an economic concept designed to reconcile the conflict between the almost limitless detail confronting accountants and auditors, and users' need for understandable information. In its May 1980 Statement of Financial Accounting Concepts No. 2, the Financial Accounting Standards Board defined "materiality" as

> "* * * the magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement."

In the same statement, the Board provides examples of quantitative materiality guidelines. These guidelines relate to specific subjects,--such as materiality for separate disclosure of items on a company's balance sheet--whereby percentage criteria have been established.

The leading court case concerning the meaning of materiality in the context of the securities laws is the case of _TSC Industries, Inc._, v. _Northway, Inc._--a case concerning the omission of certain facts from a proxy statement. The Supreme Court held that an omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.

The above traditional concept of materiality is discussed in terms of the financial information which must be disclosed to an investor. The act's accounting provisions, however, address a much broader issue--the subject of corporate accountability over assets.

Disagreement over whether the accounting provisions contain a materiality standard

There has been disagreement about whether the provisions contain a materiality standard. An ABA committee guide indicates such a standard exists, but SEC says no such standard is implied; instead a reasonableness standard applies.

ABA's guide indicates a materiality standard exists

In November 1978--less than a year after the act was passed--ABA's Committee on Corporate Law and Accounting published a guide to the act's accounting provisions. The committee said that the guide had been prepared because of (1) the importance of

In addition, other accounting guidance that could help clarify the act is contemplated. The Financial Executives Research Foundation reported in a June 1980 press release that a study was underway concerning the feasibility of establishing guidelines and criteria by which corporate executives might judge the adequacy of their control systems.

Some subjectivity will always exist

The above guidance could go a long way in assisting companies in their efforts to comply with the accounting provisions. However, because an element of subjectivity is inherent in accounting terminology, some uncertainty will probably always exist.

Public accounting officials contacted believe a major cause of uncertainty is the act's use of auditing standards to define the objectives of a corporate system of internal accounting control. These standards were originally developed to provide broad professional guidance in the independent auditor's evaluation of internal accounting control. The evaluation is made for the limited purpose of serving as a basis for setting the scope of the examination of financial statements. Only those controls on which the auditor intends to rely are tested. However, as reported by the previously mentioned AICPA committee, a company must concern itself with all internal accounting controls and identify and communicate objectives in more specific terms.

The Congress recognized the subjectivity of the accounting provisions. The committee report accompanying the Senate version of the act stated that management must exercise judgment in determining the steps to be taken and the cost to be incurred in assuring that the objectives expressed will be achieved. The report stated that the size of the business, diversity of operations, degree of centralization of financial and operating management, amount of contact by top management with day-to-day operations, and numerous other circumstances are factors management must consider in establishing and maintaining an internal accounting control system.

The Senate committee report called on the accounting profession to use its professional judgment in evaluating companies' systems of internal control. The previously mentioned AICPA committee report also recognized that compliance with the accounting provisions--particularly the internal accounting control provision--inherently calls for subjective decisions by management. The committee felt that the wide range in the size of companies, in their operating styles, in the complexity of their transactions, in the diversity of their products and services, and in the geographical dispersion of their operations clearly made it

assurance" concept requires a cost-benefit determination, there is not adequate guidance on how to determine costs and benefits.

The Financial Executives Research Foundation's study of internal controls supported the above perceptions. The study report stated that the meaning of the act's accounting terms will probably be established only in the courts. The report added that until the provisions are authoritatively interpreted, the act will continue to place a nearly intolerable burden on companies striving to comply.

Efforts to diminish uncertainty

The accounting profession and SEC have provided some guidance to business regarding compliance with the act's accounting provisions, in particular a recent policy statement of the SEC, which should diminish some of the uncertainty.

The public accounting firms contacted have published guides for corporate management to consider in designing programs and action plans to comply with the accounting provisions. The American Institute of Certified Public Accountants (AICPA) has also provided guidance. In 1977--before the act--the AICPA established a committee to develop criteria for evaluating internal accounting controls. In 1979, the committee issued its final report, which included recommendations to help corporate management appraise the effectiveness of its evaluation of internal accounting control. The committee believed the report would be useful to management in considering whether its companies are complying with the internal accounting control provisions of the act.

In various public releases, SEC has also offered guidance on steps management should consider in complying with the accounting provisions. For example, in a recent release SEC listed five steps it considered necessary to determine whether a system of internal accounting control provides reasonable assurances that the broad objectives of internal accounting controls are being achieved.

Further, in a proposed rule promulgated in April 1979, SEC called for corporate management and external auditors to make statements on the adequacy of systems of internal accounting control. In May 1980, SEC announced that it would issue no rule requiring management reporting for at least 3 years, during which time it would look to the accounting profession and business community to set their own standards for reporting on internal accounting control.

THE ACT'S ACCOUNTING PROVISIONS

The act's accounting provisions require SEC registrants to:

1. Make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets.

2. Devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that

   --transactions are executed in accordance with management's general or specific authorization;

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

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

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

The Congress adopted the "in reasonable detail" qualification because of concern that the recordkeeping requirements, if unqualified, might connote an unreasonable degree of precision. The House and Senate conference committee reported that the "in reasonable detail" provision requires that transactions be recorded in conformity with accepted methods of recording economic events and should effectively prevent off-the-books slush funds and payment of bribes.

The Congress also recognized that no system of internal accounting control is perfect. The legislative history of the act shows that in adopting the concept of "reasonable assurance," the Congress recognized that the cost of internal control should not exceed the benefits derived. The report of the Senate Committee on Banking, Housing, and Urban Affairs also recognized the need for management to use its judgment in evaluating the cost-benefit relationships of its compliance efforts.

CONFUSION OVER WHAT CONSTITUTES COMPLIANCE

Accounting, legal, and corporate officials have criticized the act's accounting provisions as being too vague concerning

The perception that the act's antibribery provisions have caused American firms to lose overseas business is difficult, if not impossible, to quantify or support because many factors influence overseas sales. However, as discussed in detail in chapter 4, some of the lost business may be due to U.S. companies forgoing legitimate export opportunities because of ambiguities in the act's provisions and suffering a competitive disadvantage due to the lack of an international antibribery agreement.

The loss of business by construction companies was reiterated in a recent Wall Street Journal article which implied that the firms hardest hit were large international construction companies dealing mainly with foreign governments or government-run industries. According to the article, some construction companies have stated that in certain countries, it is impossible even to get on the bidding lists without paying what amounts to an entry fee to a local agent who has good connections with the government in power. What impact this has had is hard to tell. However, industry statistics show that in 1977, the United States ranked fourth in worldwide construction and industrial project activity; in 1979, the United States ranked seventh. Further, one construction firm has alleged that it lost a $40 million overseas contract because its foreign competitor made a payment to a foreign official.

In February 1980, a White House task force also reported that the act has adversely affected overseas business. The task force recently completed a study of 14 export disincentives--one of which was the Foreign Corrupt Practices Act. Task Force participants included representatives from the Departments of State, the Treasury, Defense, Justice, Commerce, and Labor; the Office of Management and Budget; and the Council of Economic Advisors. Other participants were the representatives of the Special Representative for Trade Negotiations, the Assistant to the President for Domestic Affairs and Policy, and the Assistant to the President for National Security Affairs. The task force requested State Department Foreign Service officials in 45 countries to supply opinions and data on the impact of the act.

The task force found that 15 posts (33 percent) perceived the act as having a negative impact on exports--7 posts perceived the act as having a significant adverse impact. The remaining 30 posts perceived the act as having no negative impact. The 15 posts that perceived that the act had an adverse impact were in less developed countries. According to the Department of Commerce, it is these less developed countries that are major growth areas for U.S. exports.

Impact on overseas business cannot be quantified

Claims that U.S. companies have lost sales, however, are difficult, if not impossible, to substantiate and quantify because of the sensitivity of the bribery subject and the numerous factors affecting overseas business. Very few companies have publicly come forward and disclosed instances of sales lost as a result of the act. Companies may be reluctant to do this, even if promised confidentiality, because it could be construed as an admission that the company made illegal or questionable payments before the act. Further, the company could incur the wrath of the foreign country in question.

with the degree of uncertainty about costs and benefits, managers who are averse to the risk of failing to comply will probably invest more heavily in controls than they normally would for business purposes.

THE ACT IS PERCEIVED AS ADVERSELY AFFECTING U.S. OVERSEAS BUSINESS

As with the accounting provisions, the antibribery provisions may have created a cost burden. More than 30 percent of the questionnaire respondents engaged in foreign business said they had lost overseas business as a result of the act. In addition, over 60 percent perceived that--assuming all other conditions were similar--American companies could not successfully compete against other companies abroad that were bribing.

These beliefs are neither supported nor rejected by hard verifiable data. Attempts to quantify the act's impact have had only limited success. Due to the sensitivity of the foreign bribery issue and the complexities inherent in international trade, conclusive evidence of the act's impact on U.S. foreign business may never be forthcoming. However, the perceptions by themselves are important.

The act's adverse impact on U.S. corporate foreign sales has been attributed to a number of factors. In particular, business has charged that American companies are forgoing legitimate export opportunities because certain aspects of the act's antibribery provisions are ambiguous. In addition, the lack of an international antibribery agreement may be giving foreign competitors an advantage in international markets.

Throughout its deliberations on the act, the Congress was inundated with statements that corporate bribery to obtain overseas business was unnecessary. Then Secretary of the Treasury Blumenthal, testifying before one congressional committee, stated that

> "Paying bribes * * * is simply not necessary to the successful conduct of business in the United States or overseas. My own experience as Chairman of the Bendix Corp. was that it was not necessary to pay bribes to have a successful export sales program ."

Other governmental officials held similar views. Then SEC Chairman Hills stated that in every industry in which companies were bribing, other companies of equal size in that industry proclaimed that they saw no need to engage in such practices. Then Secretary of Commerce Richardson was quoted as saying that, in a number of instances, payments were made not to outcompete foreign competitors but rather to gain an edge over other U.S. manufacturers.

domestic or foreign bribes are likely to occur. More than 30 percent reported that they have increased the number of special reviews or investigations to a moderate or a great extent.

Extensive use of audit committees

Audit committees--a key component in the corporate accountability system--have evolved over the last few years. The number of companies which have such committees has grown, and the independence of the audit committee members and committee roles has been expanded. These changes were brought about largely by revelations of prior questionable corporate activities--the same activities that resulted in the act's passage.

An audit committee is composed of various members of a company's board of directors. The committee provides the auditors an opportunity for direct communication with the board, thereby strengthening their independence and objectivity. The committee meets with the auditors to discuss matters pertaining to a particular audit and to the company's accounting policies and internal controls in general.

The number of companies having audit committees has grown phenomenally. Almost all our questionnaire respondents reported that their boards of directors have audit committees. Similar results have been disclosed by other recent surveys. However, audit committees have not always been that popular. In 1967, one major public accounting firm survey indicated that only 18 percent of its clients listed on the New York Stock Exchange had audit committees. In 1973, a followup study by this firm showed the percentage had jumped to 66 percent. Also, almost all our questionnaire respondents reported that their audit committees were composed entirely of directors who were independent of management.

The New York Stock Exchange announced in January 1977 that all domestic companies with common stock listed on the exchange had to establish, by June 30, 1978, audit committees composed solely of directors independent of management. Although the American Stock Exchange does not have a similar requirement, it has adopted a recommendation that all companies listed on the exchange establish such committees.

The role of the audit committee has also undergone change. As a result of questionable corporate payments, some committees have become involved in monitoring compliance with their companies' codes of conduct. In addition, their interest in monitoring the effectiveness of internal accounting controls has increased.

Increased internal control documentation

Internal accounting control documentation--the written description of existing controls and management's evaluations of these controls--has been extensively increased as a result of the act. Over 60 percent of the respondents reported that they have increased the amount of control documentation to a moderate or a great extent.

The increases in documentation were the most extensive control changes reported. The Financial Executives Research Foundation, in its study of internal control in U.S. corporations, also found that the act resulted in increased documentation.

This is not surprising since documentation was stressed by SEC and the accounting profession as an essential part of a company's program to comply with the act. SEC has taken the position that control is enhanced by written policies and procedures, formalized channels of reporting, and written descriptions of authority and responsibility. Further, SEC has stated that documentation of control objectives and existing controls may often be necessary to perform an effective review of a system of internal accounting control.

Routine testing of controls is extensive

The act requires companies not only to design but to also maintain sufficient systems of internal accounting control. Therefore, testing the adequacy of existing controls is important.

Over 95 percent of the questionnaire respondents reported they have programs for routinely testing the adequacy of their internal accounting control systems. Further, almost 40 percent reported that as a result of the act, they had increased routine testing of accounting or control systems to a moderate or a great extent.

SEC believes that effective, ongoing evaluations of internal accounting control systems may often result in determining what improvements are needed and how they should be implemented. The accounting profession also believes that continuous monitoring of internal accounting controls is essential for determining whether the controls function properly and are still appropriate.

Strengthening internal audit

The act also has resulted in companies significantly increasing the importance and size of their internal audit staffs. Internal auditors are an integral part of an internal control system and can play a key role in evaluating whether a company is complying with the act's provisions. A strong internal audit function provides greater assurance that management policies are

The act has influenced companies to make important changes in codes

About 30 percent of the respondents reported that they made at least one important policy change in their codes. Changes in the following policy areas were most frequently cited:

--Making questionable or improper foreign payments.

--Failing to record financial transactions.

--Making false entries in company books or records.

Improper conduct in these three areas provided the major impetus for the act's passage.

The specific types of changes that our respondents made as a result of the act varied greatly. For example, over half rewrote their policies to be more specific or to expand the scope. However, only 8 percent adopted more severe disciplinary measures for code violations. Other changes and the percentage of respondents who reported making them follow.

Type of change made	Percent of respondents making this change in response to the act
More employees were informed of corporate policies.	41
Procedures for communicating policies were made more formal.	37
Employees were required to acknowledge in writing more often that they had read or would comply with the policies.	34
Policies were issued to cover type(s) of violations that had not been previously addressed.	29

A company's size did not substantially affect the act's impact on corporate codes. Only a slightly higher percentage of top 500 respondents than second 500 respondents reported that the act influenced changes in their codes.

Quantifying the impact that the above changes in codes will have in reducing questionable foreign payments is difficult, if not impossible. However, more than 70 percent of the respondents believe that the act has effectively reduced such payments by U.S. companies.

CHAPTER 2

THE ACT'S IMPACT ON CORPORATE ACTIVITIES

The Foreign Corrupt Practices Act has substantially affected corporate activities. Our sampling of 250 of the Nation's 1,000 largest industrial firms showed that the act has brought about widespread efforts to strengthen corporate codes of conduct and systems of internal accounting control. These changes, however, have not been without costs. Many corporate officials believe that the costs of complying with the act have exceeded the benefits derived. Further, the act has been cited as a cause of U.S. firms losing foreign business.

This chapter highlights the baseline data we developed concerning this significant law's impact on

--codes of conduct,

--systems of internal accounting control,

--the cost of compliance, and

--overseas business.

Most of the data was gathered through a questionnaire survey of the above 250 firms; however, where appropriate we have included information from other sources.

CORPORATE CODES OF CONDUCT HAVE BEEN GREATLY AFFECTED

Written codes of conduct are policies defining the standards of acceptable business conduct for corporate employees. Ninety-eight percent of our questionnaire respondents reviewed their policies to see if they were adequate in light of the act's requirements.

Over 60 percent of the respondents reported that these reviews had resulted in changes not only in what the policies said, but also in how they were communicated. Also, more than 50 percent reported making changes during the turbulent 4-year period before passage of the act; 25 percent did not find it necessary to make any further changes as a result of the act.

What effect the changes in the codes will have in reducing questionable payments is difficult to determine. However, more than 70 percent of the respondents believed that the act has effectively reduced questionable foreign payments by U.S. companies.

With the assistance of an expert in the design of questionnaires and a consultant with nationally recognized accounting expertise, we designed a corporate questionnaire which addressed the act's relationship to the following four areas:

--Corporate policies and/or codes of conduct.

--Corporate systems of accountability.

--Cost burdens, if any, incurred by management to comply with the act.

--Corporate opinions regarding the (1) act's effect on U.S. corporate foreign sales, (2) clarity of the act's provisions, (3) potential effectiveness of an international antibribery agreement, and (4) perceived effectiveness of the act in reducing questionable payments.

Most of our questionnaire survey was conducted by mail. The questionnaire was self-administered, and the data collection process allowed companies to remain anonymous. However, to determine the validity of responses to our mailed questionnaires, we visited 27 companies picked at random from our sample to administer the questionnaire in person and to review documentation considered necessary to assess the credibility of the respondents' answers to certain objective questions. Statistically, the responses obtained during these visits compared favorably with the responses obtained from the mailed questionnaires, thereby supporting the results of our mailed questionnaires.

A copy of our questionnaire, including a summary of the corporate responses to each question, is contained in appendix I. Appendix II describes our survey and sampling procedures in more detail.

Scope of review

Using standardized questionnaires, we solicited information regarding the act's impact on corporate activities from the above-mentioned 250 corporations. One hundred eighty-five, or about 75 percent, of these companies responded. The respondents covered a wide range of industries as shown by the list in appendix III.

We also discussed the act's impact with representatives from

--the leading public accounting firms,

--professional accounting and auditing organizations,

--professional legal associations, and

--cognizant business and public interest groups.

objectives for systems of internal accounting control. The antibribery provision applies to SEC registrants and domestic concerns, as well as to officers, directors, employees, or agents acting on behalf of such companies. The accounting standards apply only to SEC registrants. "SEC registrants" are defined as all U.S. companies that have a class of securities registered with SEC and/or file reports with SEC under the Securities Exchange Act of 1934. A "domestic concern" is defined as (1) any U.S. citizen, national, or resident or (2) any business entity (other than an SEC registrant) that either has its principal place of business in the United States or is organized under the laws of any U.S. State, territory, commonwealth, or possession.

Antibribery provisions

The act prohibits both SEC registrants and domestic concerns from corruptly offering or giving anything of value to

--a foreign official, including any person acting in an official capacity for a foreign government;

--a foreign political party official or political party; or

--a candidate for foreign political office.

The above prohibitions relate to offers or payments made to influence these officials in order to help a registrant or domestic concern obtain or retain business or direct business to any person.

The act also prohibits the offering or paying of anything of value to any person if it is known or if there is reason to know that all or part of the payment will be used for the above prohibited actions. This provision covers situations when intermediaries, such as foreign affiliates or agents, are used to channel payoffs to foreign officials.

The potential penalties for violating the antibribery provisions are severe. SEC registrants and domestic concerns (other than an individual) can be fined up to $1 million. Individuals who are domestic concerns and any officer, director, or stockholder who acts on behalf of a registrant or domestic concern and who willfully violates the law can be fined up to $10,000 and imprisoned for not more than 5 years. The law prohibits companies from directly or indirectly paying a fine imposed on an individual.

Accounting provisions

These provisions, which apply only to SEC registrants, contain requirements for recordkeeping and internal accounting controls. They were adopted in response to SEC and congressional discoveries that foreign bribery was accomplished mainly by (1) off-the-books slush funds and (2) transactions inaccurately recorded on a firm's books.

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ABBREVIATIONS

GAO	General Accounting Office
SEC	Securities and Exchange Commission
ABA	American Bar Association
AICPA	American Institute of Certified Public Accountants

RECOMMENDATIONS TO THE DEPARTMENT OF JUSTICE AND THE SECURITIES AND EXCHANGE COMMISSION

GAO further recommends that the Attorney General and the Chairman of SEC, with input from other interested agencies, jointly develop alternative ways to address the ambiguities in the antibribery provisions. GAO offers several options to consider.

GAO also recommends that, because of the questions and concerns surrounding the antibribery provisions, these alternatives be reported to the cognizant congressional committees by June 30, 1981. (See p. 48.)

AGENCY COMMENTS

SEC stressed the positive impact of the act. SEC commented that GAO's questionnaire survey establishes an empirical data base which provides information that will assist in assessing the impact and implementation of the act. SEC said that GAO's report, which it called a significant contribution, helped in clarifying its own views. SEC also said that it stands ready to assist business in complying with the act. It said that GAO's recommendation calling for additional guidance on compliance with the accounting provisions appeared to be within the framework of the law, but was not sure exactly what was intended and expressed concern the recommendation could be too rigid and inflexible to provide for proper management judgment. To ensure that its position is understood, GAO has clarified this recommendation. (See app. IV.)

SEC disagreed with GAO's recommendations regarding the antibribery provisions as did the Justice Department which also challenged the questionnaire survey. GAO stands behind the statistical validity of its questionnaire survey and the feasibility of its recommendations to address business concern with the clarity of the antibribery provisions. (See app. V.) The State Department agreed with GAO's recommendations calling for alternative ways to address the ambiguities in the antibribery provisions. (See app. VII.) The Commerce Department, although seemingly supporting the report, did not expressly address GAO's recommendations. (See app. VI.)

The recommendation calling for decriminalization of the accounting provisions was not included in GAO's draft report and, therefore, not addressed by the agencies commenting.

ambiguities have been cited as a possible cause of U.S. businesses forgoing legitimate export opportunities. For example, companies are unsure about the degree of their responsibility for questionable payments made by their foreign agents in cases when the companies believe they have instituted reasonable safeguards. (See pp. 38-41.)

Because of concern that U.S. businesses were forgoing legitimate export opportunities, President Carter directed the Justice Department to provide guidance to the business community regarding enforcement priorities under the antibribery provisions. The Justice guidance program was implemented in March 1980--18 months after the President's directive. The program, which is voluntary in nature, requires that a company submit a detailed statement of all facts material to a prospective transaction in a foreign country. Justice then advises whether it would take enforcement action under the act if the company proceeded with the transaction. (See pp. 41-42.)

The program has yet to effectively address the ambiguities in the antibribery provisions, and it is doubtful it will. To date, only a few companies have requested opinions, and the program faces an uphill struggle. The program has been criticized by some Government and business community officials for not establishing guidelines through the use of hypothetical situations. In addition, some officials believe it should be a joint Justice-SEC program, since these organizations share enforcement responsibility for the antibribery provisions. Although SEC refused to participate, it recently announced that it would abide by Justice's enforcement intentions until at least May 31, 1981. (See pp. 42-45.)

Also affecting business perception of the act is the lack of an international antibribery agreement. Over 60 percent of the questionnaire respondents reported that, assuming all other conditions were similar, American companies cannot successfully compete abroad against foreign competitors that are bribing. Efforts since 1976 to reach an international antibribery agreement have been unsuccessful. The United States has recently intensified its efforts, and an international ban by seven industrialized nations may be obtained in the near future. (See pp. 45-46.)

GAO believes that because the Justice program has not effectively addressed the uncertainty over what

THE ACT HAS SUBSTANTIALLY AFFECTED CORPORATE ACTIVITIES

A GAO questionnaire survey of 250 companies randomly selected from the Fortune 1000 (75 percent responded) shows that the act has brought about efforts to strengthen corporate codes of conduct and systems of internal accounting control.

Codes of conduct--the policies that define the standards of business conduct for employees--have undergone significant change. About 60 percent of the questionnaire respondents stated that the act has influenced changes in their codes' contents as well as in how they are communicated to employees. Important changes were frequently reported in the policy areas related to questionable or improper foreign payments. (See pp. 6-9.)

The act has also caused almost all respondents to review the adequacy of their systems of internal accounting control; more than 75 percent reported making changes. Extensive changes have been made in documenting and testing internal accounting control systems and in strengthening internal auditing. (See pp. 9-12.)

These changes have not been without cost. About 55 percent of the respondents reported that their efforts to comply with the act have resulted in costs that were greater than the benefits received. About half these respondents believed that the cost burden increased their accounting and auditing costs by 11 to 35 percent. (See pp. 13-14.)

Further, more than 30 percent of the respondents engaged in foreign business reported they had lost overseas business as a result of the act. Aircraft and construction companies were particularly hard hit, with over 50 percent of aircraft and construction companies reporting, in a separate questionnaire survey, that they had lost overseas business. This belief is neither supported nor rejected by hard verifiable data. Due to the sensitivity of the foreign bribery issue and the numerous factors affecting overseas business, conclusive evidence may never be forthcoming. However, the perception by itself is important. (See pp. 14-17.)

CONFUSION AND CONTROVERSY OVER THE ACT'S ACCOUNTING PROVISIONS

Business perception that the accounting provisions have resulted in costs greater than the benefits

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