THE FOREIGN CORRUPT PRACTICES ACT – THEN AND NOW.

BY

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HOW IT ALL BEGAN

In my 47 years as a government and private sector attorney, there is no accomplishment of which I am more proud than the contribution I made by assisting in the creation of the FCPA. The FCPA was not the result of some bureaucrat who, without provocation, thought that this was a law that should be on the books. Instead, it came about as a reaction to certain highly questionable activities of many of our international corporations that became public as a result of investigations conducted by the SEC.

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It all began at a time when I was Director of the SEC's Division of Enforcement. This was a time when the Watergate hearings were great television fare. I followed the hearings very closely. The corporate officials offered no great revelations compared to those presented in the testimony of "All the President's Men," but at the tail end of the hearings, a number of these corporate officials testified about impermissible contributions made by their corporations to President Nixon's re-election campaign. I found this testimony fascinating. Interestingly, the committee made no searching inquiry into the methodology used by the corporations to make the payments.

Because of my CPA background, the testimony immediately prompted several accounting questions: How did a publicly traded corporation record such an illegal transaction? What if any information did the outside auditors have?

I asked one of my staff members to commence an informal inquiry to determine how these transactions were booked and the answer came back quickly – the political contributions were

disguised on the contributing corporations' books and records. Careful planning by top corporate officials assured that illegal political contributions were not disclosed on the companies' books and records.

But the inquiry revealed something more. We discovered that the use of company funds was not confined to illegal political contributions. Indeed, secret funds were used to make many other forms of illicit payments, including payments of bribes to high officials of foreign governments. At this point the inquiry was expanded into a full fledged investigation.

The results of the investigation were staggering. As reported by the Department of Justice, "over 400 U.S. companies admitted making questionable or illegal payments in excess of $300 million to foreign government officials, politicians and political parties." This included 117 of the top Fortune 500 corporations.

The caseload at the SEC mounted and actions were initiated against some of the nation's most prestigious corporations. A creative solution became essential. Congress came to the

Commission's assistance. Former Senator William Proxmire of Wisconsin was so shocked by what the SEC was uncovering that he asked me what, if any, legislation could help the SEC to continue to ferret out illicit corporate activities. When the call came I was fully prepared.

Bringing to bear both my legal and accounting training, I analyzed the various cases the SEC had brought and came to the conclusion that in no instance was an illicit payment recorded in the corporations' books for what it was. The payments were carefully disguised. I advised him that in my view, a very simple one-line statute would be helpful in stopping this activity. In the spirit of the SEC's full disclosure and transparency laws, I told him all that was necessary was a law requiring a corporation to keep fair and accurate books and records. He was skeptical, but he had enough confidence in me to enact my suggestion into law.

But that was not all Congress did. It also accepted a proposal from the Commission's brilliant Chief Accountant, Professor Sandy Burton, to add a provision requiring corporations

to put in place an effective system of internal controls. In addition, Senator Proxmire, not entirely satisfied that such a seemingly benign-sounding provision would be effective, added a specific anti-bribery provision to the law which explicitly made it unlawful for a U.S. corporation to bribe foreign officials. Finally, Congress extended the bribery provisions of the law beyond U.S. public corporations and made them apply equally to U.S. private corporations.

And so the Foreign Corrupt Practices Act was born.

ENFORCEMENT ACTIONS UNDER THE ACT

The FCPA has had a very vibrant history. Enforcement responsibilities under the Act are divided between the DOJ and the SEC. Over the years, both agencies have demonstrated a willingness to prosecute large and mid-sized companies and often high level officers of companies, alleged to have been involved in FCPA violations all over the world. Indeed cases have arisen out of activities in over twenty different countries such as Angola,

Argentina, Brazil, Canada, Columbia, the Cook Islands, Costa Rica, the Dominican Republic, Egypt, Germany, Haiti, Kazakhstan, Nigeria, and the list goes on.

The SEC and the DOJ have been actively bringing cases under the Act since its inception in 1977. Allegations of criminal violations of the FCPA are generally investigated by the FBI, under the supervision of the Fraud Section of the DOJ's Criminal Division. The person heading that unit is one of the finest careerists in government – Peter Clark – a former colleague of mine at the SEC.

Allegations of civil violations of the FCPA anti-bribery provisions by non-public corporations are also investigated by the DOJ. On the other hand, allegations of civil violations of the recordkeeping and anti-bribery provisions of the FCPA by public issuers, can be investigated both by the DOJ and the SEC.

To date, the SEC has brought approximately 18 cases against individuals and companies for violations of the books and records and internal control provisions of the Act. In addition, the

SEC has brought some 10 cases under the anti-bribery provisions. Few of these cases are ever litigated. They are usually settled by a civil consent decree.

The DOJ has been even more active. Since the FCPA's inception, the DOJ has brought some 60 criminal actions against individuals and some 40 criminal cases against corporations. These cases are usually settled by a criminal plea. In addition the DOJ has brought some 9 civil actions under the Act.

INTERPLAY WITH SARBANES-OXLEY

The FCPA requires public issuers to devise and maintain a system of internal accounting controls that assures:

- Execution of transactions only in accordance with management's authorization which need to be recorded in conformity with GAAP;
- Access to assets only in accordance with management's authorization;
- The maintenance of the accountability for assets; and

- Appropriate action when a comparison between existing assets and recorded assets demonstrates differences;

The current rash of corporate misconduct however, has prompted Congress to act again. Under Section 404 of the newly enacted Sarbanes-Oxley legislation, the SEC has recently issued rules that require public corporations to include in their annual reports

> "a statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting for the company; management's assessment of the effectiveness of the company's internal control over financial reporting as of the end of the company's most recent fiscal year; a statement identifying the framework used by management to evaluate the effectiveness of the company's internal control over financial reporting; and a statement that the registered public accounting firm that audited the company's financial

statements included in the annual report has issued an attestation report on management's assessment of the company's internal control over financial reporting. Under the new rules, a company is required to file the registered public accounting firm's attestation report as part of the [company's] annual report."

But with the FCPA already on the books, one must ask the question why was it necessary to further tighten the law by enacting Section 404? It is disappointing to me, that the corporate community did not learn its lesson under the FCPA, and may simply "not get it," as the youngsters say. While Section 404 has caused much consternation, the corporate community really only has itself to blame.

In a recent study done by Financial Executive Magazine (September 2004 issue,) the following was reported:

- Despite an extension in the deadline from June 15 to November 15, 2004, half of large U.S. companies

polled are still less than 60 percent complete in meeting their SOX Section 404 filing requirements.

- A poll of 248 senior audit professionals at corporations with more than $1 billion in revenues, reports considerable challenges in meeting the filing requirements under Section 404. And despite recognizing the need for continuous auditing and monitoring, many seem to be taking a short-term approach to compliance.
- A survey found that 67 percent of respondents have no annual budget allocated to maintain Section 404 compliance after the initial filing requirement, and one quarter are only mildly confident or not confident at all in their company's ability to maintain Section 404 compliance after the first filing.

The SEC has now stepped in with a new proposal to give companies another chance to comply with the reporting requirements. The SEC's proposal would postpone for one year

the 60 day filing deadline for Form 10K. In other words, companies filing 2004 10Ks will continue to have 75 days after the fiscal-year-end to file.

THE NEXT STEP

Returning to the FCPA, in my view we need more than Congress passing new statutes, and the SEC requiring strict compliance with existing legislation. We need a comprehensive assault on the problem. This means we need the assistance of our government and indeed all the countries of the world along with the world business community, to provide a climate which enables our corporations to compete honestly and fairly throughout the world. There is a way to fix this problem if there is a will to do so.

Here is my prescription of the steps we need to take to assist in this effort:

- The establishment of a country-by-country list of agents that have been properly vetted and have agreed to be

examined and audited by an independent international auditing group.

- An independent auditing group would be set up and approved by the world community, with the SEC playing a major role in the establishment of such an entity.
- Each country would need to require that agents on the list agree to:
  - Perform only real and necessary services to effectuate the transaction with all payments being consistent with the work performed;
  - Avoid using proceeds to pay any member of the government or other third party to obtain business;
  - Cooperate in any investigation by U.S. and international authorities;
  - Certify under oath that it has not bribed government officials to obtain the contract;

- Agree to being audited by the independent international auditing group;
- Accept only a reasonable fee for services; and
- Provide a bond at twice the amount of all fees received or to be received by the agent to be forfeited in the event the agent does not fulfill any of the enumerated undertakings;

- Countries would only allow the use of approved local agents.
- Countries would further agree to have every material contract audited by the international accounting group, noted above.
- The independent auditing group would audit all contracts with an amount over a certain threshold, awarded by a "listed government" - a country listed as "at risk" in a publication such as the Transparency International Corruption Perceptions Index.

- The audit would determine whether the contract was awarded fairly, with no money being paid by the company awarded the contract, to government officials directly or indirectly in violation of the FCPA.
- "Listed governments" would be incentivized to participate in such audits by gaining eligibility to obtain certain benefits from the World Bank and other world financial institutions as well as from the nations where the contracting companies are domiciled.

Pending approval of the above, our domestic corporations must take steps to further protect themselves from violating the FCPA. In this regard, I would suggest that domestic corporations, operating in the vulnerable areas of the world, make sure that when they engage the services of a so called 'agent', that they perform due diligence.

This would include determining the reputation of the agent and the services that are necessary for the agent to perform, making sure that the payments made are commensurate with the

services performed, and that a contract with an agent requires him/she to be audited by the domestic corporation's accounting firm. It is also important to obtain from the agent, a statement under oath that no monies have gone or will go to a government official and that the agent has no arrangements to pay a government official either directly or indirectly.

As I am sure you realize, it is important to have a comprehensive compliance program. This would include training as well as routine legal compliance audits. Most important would be the inculcation of a culture that no contract, no matter how lucrative, is worth the risk of subjecting the corporation and its officers to civil and criminal sanctions.

It's obvious that our private sector has fallen down on the job. The business culture has got to change and that has to happen now. The responsibility to do so must start with the company's management and its board of directors. The gatekeepers or access givers (lawyers, accountants etc) also have key roles to play. It is time to act and that time is now.