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Report to Sen. William Proxmire, Chairman, Senate Committee on Banking, Housing and Urban Affairs; by Robert F. Keller, Acting Comptroller General.

Issue Area: Federal Procurement of Goods and Services: Reasonableness of Prices Under Negotiated Contracts and Subcontracts (1904).
Contact: Procurement and Systems Acquisition Div.
Budget Function: National Defense: Department of Defense - Procurement & Contracts (058).
Organization Concerned: Lockheed Aircraft Corp.; Department of Defense; Department of the Treasury.
Authority: Anti-Kickback Act (41 U.S.C. 51-54). International Security Assistance and Arms Export Control Act of 1976 (P.L. 94-329). 41 U.S.C. 22. 18 U.S.C. 431. 18 U.S.C. 433. 10 U.S.C. 2207. 10 U.S.C. 2306(b). 41 U.S.C. 254(a). Executive Order 9001.

Some aspects of Lockheed's foreign sales commission payments were examined to determine whether commissions were improperly charged to Government contracts, the impact of disclosure of payments on sales, and the existence of outstanding commitments to foreign officials. Since disclosure of the payments, Lockheed has taken action to institute more effective controls. Findings/Conclusions: There was no evidence that questionable foreign payments were improperly charged to U.S. Government contracts. With the exception of uncertainties associated with potential sales to Japan, there was no evidence that disclosure had adverse effect on current or future foreign sales. In Japan, there may have been effects on the market potential of an antisubmarine warfare aircraft program and the execution of orders for TriStar aircraft. There were outstanding commitments to international consultants for commissions totaling about $48 million as of June 30, 1975, but Lockheed has refused to make payment to an official of a foreign government-owned company and the case is now in litigation. Questionable foreign marketing practices were considered symptomatic of similar actions by other corporations and initiatives are underway in Congress and executive agencies to deal with this matter. (HTW)

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REPORT TO THE CHAIRMAN, COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

RELEASED 3/31/77

Lockheed's Commission Payments To Obtain Foreign Sales

Lockheed Aircraft Corporation

GAO found no evidence that Lockheed's questionable foreign payments were improperly charged to U.S. Government contracts. Except for some uncertainty on certain sales to Japan, the disclosure of the payments has not had an adverse impact on the firm's current or future sales. Lockheed has refused to make payment on an outstanding commitment to a foreign official of a government-owned company and the case is now in litigation.

PSAD-77-85

MARCH 15, 1977

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

B-169300

The Honorable William Proxmire
Chairman, Committee on Banking,
Housing, and Urban Affairs
United States Senate

Dear Mr. Chairman:

In response to your request, we have reviewed certain information with respect to foreign sales commission payments made by Lockheed Aircraft Corporation during the 5-1/2 year period ending June 30, 1975. The issues addressed in this letter pertain to (1) whether any of the commissions were improperly charged to U. S. Government contracts, (2) the potential impact on current and future sales due to disclosure of commission payments, and (3) whether Lockheed has any outstanding commitments to foreign officials incurred prior to the new company policy restricting such payments. In addition, we have compiled a summary of the initiatives underway in Government and the private sector to deal with the problem of questionable foreign payment practices.

In our review, we found no evidence that commissions on foreign sales were improperly charged to Government contracts. Although we believe the new management policy and procedures established by Lockheed contain suitable control features over its own foreign marketing activities, Lockheed has no control over the ultimate disposition of otherwise legitimate commission payments. Also, with the exception of uncertainties associated with sales to Japan, the disclosure of commission payments has not had an adverse impact on current or future sales to foreign customers. However, Lockheed believes that the final assessment of the impact will not be known until their Special Review Committee report is released. In regard to outstanding commitments, we found that Lockheed has a contingent liability of $4.7 million to an official of a foreign company that made purchases from Lockheed. This matter is now in litigation.

BACKGROUND

In July 1975, the company publicly acknowledged that, from January 1, 1970, through June 30, 1975, about $147 million in foreign sales commissions were paid to consultants. Lockheed disclosed that about $24 million of the payments were known or suspected to have been received by

foreign officials and foreign political organizations. Subsequently, the Securities and Exchange Commission (SEC) filed a complaint against Lockheed alleging secret payments of at least $25 million to foreign government officials that resulted in the filing of inaccurate statements with the Commission.

Lockheed entered into a consent decree with the SEC in April 1976, requiring the company's Board of Directors to establish a Special Review Committee to investigate and report on past practices relating to commissions and other payments made in connection with foreign sales activities. Although the consent decree required the investigation to be completed by August 1976, the completion date was extended and a final report is not anticipated before the latter part of March 1977.

Shortly after disclosure of the commission payments, Lockheed took action to institute more effective controls over the selection and approval of international marketing consultants and related payment procedures. The management policy established in October 1975 prescribed the following restrictions:

1. No consultant shall be an official or employee of the government or an active member of the armed forces of the country in which services are to be rendered unless such dual activity is permissible in the country involved and is approved in writing by the head of the government agency or senior officer of the armed service.

2. No consultant shall be an officer, director, employee or "affiliate" of any customer unless such dual activity is permissible in the country involved and is approved in writing by the chief executive officer of such customer.

3. Payments shall only be made by check or bank transfer to the order of the consultants.

4. No consultant shall make payments to third parties in connection with performance under the agreement if such payments would (1) not constitute a deduction by Lockheed for U.S. tax purposes, (2) be in violation of applicable U.S. and customer country laws, or (3) be for political purposes.

5. Consultants shall comply with applicable laws of the United States and the customer country.

6. Written consultant certifications are required in connection with 4 and 5 above for each payment.

We found that Lockheed's policy and procedures contain controls that provide a reasonable degree of assurance that the company itself will not make payments to foreign governmental, military, or customer officials for their influence in securing sales. It should be noted, however, that there are some external factors in the foreign market beyond Lockheed's control and that the company's actions alone may not necessarily preclude the possibility of money ultimately flowing to such officials.

The first factor to be considered is the amount of money that is paid to consultants for their services in securing sales for companies they represent. The amounts paid are not controlled or determined by Lockheed alone, but rather by prevailing rates in a foreign country and in an industry. It seems that the probability of consultants offering payments to unauthorized third parties in influential positions and such third parties accepting the offers increases as the amount of money involved increases.

A second factor to consider is the accepted business customs and practices in the foreign countries themselves. In the past, it was the practice in some countries to make payments to officials of the government, military, or customer for their influence in securing sales. It seems that Lockheed's actions alone would not necessarily halt such practices by Lockheed's consultants as discussed below.

Thirdly, while Lockheed consultants contractually agree not to make payments to unauthorized third parties and certify that they are not doing so, it should be recognized that Lockheed has no means of its own to determine what a consultant ultimately does with money received from the company. This fact, in light of the money that can be received for securing sales and the business practices within the foreign countries themselves, would seemingly have an impact on a consultant's actions relative to third parties.

It is possible that a greater degree of assurance on the ultimate disposition of monies paid to consultants would result from country-to-country agreements on ethical business practices and vigorous in-country enforcement. Such agreements probably would require political and diplomatic involvement and accordingly would be beyond the purview of Lockheed or any other corporation doing business in foreign countries.

We found further that Lockheed's implementation of the policy was generally adequate. Lockheed established a committee to review consultant qualifications that did not cover consultants under agreements predating the policy. The company agreed to have the committee review the qualifications of these consultants.

Since Lockheed publicly announced its past foreign payment practices, the Emergency Loan Guarantee Board has been working to prevent future improper foreign payments. To this end, the Loan Guarantee Agreement was subsequently amended, effective as of September 8, 1976. Under the amended agreement, the making of any improper payment or failure to comply with the management policy could constitute an event of default on the part of Lockheed which could result in a termination of the Government guarantee. In addition, Lockheed is required to make periodic reports and certifications to the Board regarding its compliance with the management policy.

EFFECT ON U.S. GOVERNMENT CONTRACTS

It appears that with the exception of approximately $1 million properly charged to foreign military sales contracts, none of the reported $147 million of commission payments was charged to Government contracts. The foreign military sales regulations permit the inclusion of commission payments in the contract price as long as they are disclosed and are reasonable in amount. Our examination included a selective verification of payments to the supporting documentation and a test of the work performed by the Defense Contract Audit Agency and Lockheed's external auditors in their special examinations of Lockheed's commission payments. With respect to commission payments made by Lockheed's wholly-owned subsidiaries in Geneva, Switzerland, we relied on the results of work performed by the company's external auditors as access to pertinent records by foreign government auditors would violate Swiss law.

EFFECT ON POTENTIAL FOREIGN SALES

With the exception of uncertainties associated with potential sales to Japan, we found no evidence that the disclosure of Lockheed's commission payment practices has had an adverse effect on current or future sales to foreign customers. In one geographic area, for instance, where questionable payments were known or suspected to have been made, the company has already consummated a significant part of its projected sales. However, Lockheed officials believe that final assessment of the impact will not be known until after the release of the Special Review Committee report.

The political climate in Japan resulting from disclosure of commission payments to government officials has affected Lockheed's potential sales to that country. Lockheed reported that the disclosure may have adversely affected the market potential of a P-3 Orion antisubmarine warfare aircraft program valued at about $300 million over a 10-year period. This was to have been a production and licensing arrangement. The disclosure has also contributed to a delay in the execution of three firm orders for L-1011 TriStar aircraft from Japanese airlines valued at about $78 million.

OUTSTANDING COMMITMENTS TO FOREIGN PUBLIC OFFICIALS

Lockheed reported that as of June 30, 1975, it had outstanding commitments to international consultants for sales commissions totaling about $48 million. We were informed by Lockheed that $4.7 million represented a contingent liability to an official of a foreign government-owned company.

Lockheed has refused to make payment to the company official because of restrictions in the company's current management policy. Lockheed's general counsel indicated that the consultant has initiated proceedings in a foreign court to recover unpaid commissions.

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We believe that Lockheed's questionable foreign marketing practices are symptomatic of similar actions by many other American corporations. We believe it is a serious problem and have set forth for your information the major initiatives currently underway dealing with this subject. (See Appendix.)

We are sorry for the length of time required to respond to your request, but as you know, it took months to make the necessary arrangements with Lockheed to gain access to the needed records and further time to work out procedures for dealing with the highly complex and sensitive matters involved.

We are currently working on our annual report on the implementation of the Emergency Loan Guarantee Act and will issue it shortly.

Sincerely yours,

ACTING Comptroller General
of the United States

Enclosure

ACTIONS TAKEN OR UNDERWAY TO PREVENT IMPROPER CORPORATE EXPENDITURES

BACKGROUND

Over the past few years, many American corporations have disclosed payments made abroad to foreign government officials, political parties and others in anticipation of business advantages. These payments were usually made for one or more of the following reasons: (1) as petty corruption or "grease" payments to facilitate favorable action, (2) to gain competitive advantage over other competing firms, or (3) because of extortion by corrupt officials or their agents.

According to the Presidential Task Force on Questionable Corporate Payments Abroad, these activities and their subsequent disclosure tend to affect our foreign relations with certain countries, the international stature of multinational corporations, and, in broader terms, confidence in "free" institutions.

In making these payments, many corporations have violated ethical, and, in some cases, legal standards of both the United States and the foreign countries. Some corporations have reportedly falsified records, lied to auditors, used off-the-books "slush" funds and, in some cases, illegally deducted the improper foreign payments as ordinary and necessary business expenses for Federal income tax purposes. In addition to conducting improper business practices abroad, several major corporations have reportedly made illegal political contributions in the United States.

The Congress, several Federal agencies and international organizations, as well as activities in the private sector, are currently trying to determine the effects of these improper business activities. The ongoing inquiries are focusing on the effectiveness of applicable laws and regulations and the possible need for additional corrective action.

Existing laws and actions taken or underway that relate to this matter are outlined below.

Specific Laws Regarding Improper Payments In Connection with U. S. Government Contracts

1. General

There are several statutes that bear upon the question of improper payments made to secure Government contracts.

These statutes are in turn implemented by contract clauses that must be inserted in Government contracts. If GAO, in its audits of negotiated contracts, finds a violation of these laws or contract provisions, it generally refers the matter to the procuring agency if it is a civil matter involving a price reduction, or to the Department of Justice for investigation and possible prosecution if it is a criminal violation.

2. "Officials Not to Benefit"

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

This matter is further dealt with in the Criminal Code. Section 431 of Title 18 of the United States Code provides for criminal penalties for Members of or Delegates to Congress, or resident commissioners who have a prohibited share of a Government contract. This provision does not apply to corporations in which the person may hold stock (18 U.S.C. 433). The code also provides that contracts made in violation of this law are void and the Government can recover any money paid under the contract.

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

3. "Covenant Against Contingent Fees"

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

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

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

Should this requirement be violated, the Government may (1) annul the contract, or (2) deduct from the contract price the full amount of the contingent fee or commission.

4. "Gratuities"

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

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

5. "Anti-Kickback Act"

The "Anti-Kickback Act" prohibits any subcontractor from making a gift to a prime contractor or his employee as an inducement for the award of the subcontract (41 U.S.C. 51-54). The law provides that the United States may recover the amount so paid. While the law does not expressly provide for cancellation of the subcontract, the Supreme Court has held that that was a proper remedy for public policy reasons. The law also provides that for the purpose of enforcing the law, GAO has the "power to inspect the plants and audit the books and records" of any prime or subcontractor engaged in performing a negotiated Government contract. GAO has also recommended that a specific clause be included in each negotiated Government contract to prohibit payments of gratuities by subcontractors to higher tier contractors involved in Government contracting. (See Report to the Subcommittee on Priorities and Economy in Government, Joint Economic Committee, PSAD-76-23, November 19, 1975.) The Office of Federal Procurement Policy is currently considering a requirement for such a clause in negotiated contracts.

GAO's Legal Authority to Audit Contractor Books and Records

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

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

Similar laws exist regarding contracts negotiated by other Federal agencies.

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

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In addition to the laws discussed above, a number of proposed actions are being considered or taken by the Congress, U.S. Government agencies, and international organizations as discussed below.

CONGRESSIONAL ACTION

The Subcommittee on Multinational Corporations of the Senate Foreign Relations Committee held hearings in mid-1975 on the circumstances that led to, and the legality of, corporate payments abroad. The hearings focused on questionable foreign payments by Exxon, Gulf Oil, Mobil, Northrop, and Lockheed.

The Senate Banking, Housing and Urban Affairs Committee held a hearing on August 25, 1975, dealing with the questionable foreign payments by Lockheed. The hearing centered upon the Emergency Loan Guarantee Board's position and action on the payments by Lockheed, the only borrower under its program.

APPENDIX

In October 1975, the Subcommittee on International Trade of the Senate Finance Committee held hearings on Senate Resolution No. 265, a resolution to protect the ability of the United States to trade abroad. The resolution, which passed on November 12, 1975, states that the Special Trade Representative for Trade Negotiations and other appropriate officials should start negotiations on the development of a code of conduct in international trading.

Both the Senate Banking, Housing and Urban Affairs Committee and the Subcommittee on Multinational Corporations of the Senate Foreign Relations Committee held additional hearings in early 1976. During the Banking Committee hearings, it was argued that the bribes were related to the question of Lockheed's ability to repay its Federally guaranteed loans. Lockheed stated that its foreign payments had not involved funds from the guaranteed loans.

During the course of its hearings, the Subcommittee on Multinational Corporations publicly released many Lockheed documents showing an extensive pattern of payments in Japan and Europe. These revelations touched off political repercussions in Japan, Italy, and the Netherlands, jeopardized some of Lockheed's foreign sales, and prompted several nations to begin their own investigations of the questionable corporate payments. (See p. 16.)

The Subcommittee on Priorities and Economy in Government of the Joint Economic Committee held hearings in March 1976 to determine the State Department's policy on the issue of corporate bribery abroad. It was announced that the United States would propose a multilateral agreement on corrupt practices before the United Nations Commission on Transnational Corporations. (See p. 18.)

The Senate Banking Committee completed action on several bills in June 1976 and reported out S. 3664 on July 2, 1976, to deal with "corrupt overseas payments by U.S. business enterprises." On June 11, 1976, the Committee received interim recommendations from the Presidential Task Force on Questionable Corporate Payments Abroad. (See p. 17.)

On September 15, 1976, the Senate passed S. 3664 which (1) prohibits direct or indirect payments made to a foreign official to assist a U.S. company's business dealings with that government, (2) requires corporations registered with the SEC to keep accurate books and records and to maintain a system of internal accounting controls to insure that

management would be able to prevent future prohibited payments, and (3) makes it illegal to mislead an accountant by lying or by making statements that exclude material facts. The Subcommittee on Consumer Protection and Finance of the House Commerce Committee held hearings in September 1976 on an identical bill (H. R. 15481), but did not complete action prior to the congressional recess. A new Senate bill (S. 305) was introduced on January 18, 1977, and contains, among other measures, the same provisions as S. 3664. A new House bill (H.R. 1602) was introduced on January 10, 1977, which is identical to H.R. 15481.

The 1976 International Security Assistance and Arms Export Control Act (P. L. 94-329) was signed into law on June 30, 1976. One provision of the act requires that a report be submitted to Congress within 60 days if the President determines that officials of a foreign country receiving security assistance have (1) obtained illegal or otherwise improper payments from a U. S. corporation in return for a contract to purchase defense articles or services, or (2) extorted money or other things of value in return for allowing a U. S. citizen or corporation to conduct business in that country. The report shall recommend whether or not the United States should continue the security assistance program for that country. On September 16, 1976, the State Department, in response to requirements of P. L. 94-329, adopted new regulations which require reporting of political contributions and fee or commission payments on foreign military sales and certain foreign commercial sales.

A bill on corporate bribery, submitted by Senator Harry F. Byrd, Jr., was adopted as an amendment to the 1976 Tax Reform Act which became law (P. L. 94-455) on October 4, 1976. The amendment requires that all U. S. companies, which have foreign subsidiaries, report to the Secretary of the Treasury all direct or indirect payments made to employees, officials or agents of any foreign government. If determined by the Secretary to be an illegal bribe, foreign bribe-produced income would not be entitled to any foreign tax benefits. Also, foreign bribe-produced income of a domestic international sales corporation (DISC) will be immediately taxable. The House-Senate Conference Committee on the bill altered the Byrd amendment to provide that bribes paid by a DISC to foreign officials will be immediately taxable. Current law provides that such bribes are not deductible, but permits deferral of the tax on the money.

APPENDIX

The Subcommittee on International Economic Policy of the House International Relations Committee held several hearings in 1975 and 1976 on the policy effects of corporate payments abroad. Subsequently, the full Committee reported out a bill (H.R. 14681) to provide for the termination of investment insurance and guarantees issued by the Overseas Private Investment Corporation where the investor makes a significant payment to a foreign government official to influence the actions of such government. The bill passed the House on August 24, 1976.

The Senate Foreign Relations Committee approved Senate Resolution No. 516, supporting the United States participation in the Organization of Economic Cooperation and Development Declaration on International Investment and Multinational Enterprises. The resolution passed the Senate on October 1, 1976.

U. S. GOVERNMENT AGENCIES' ACTIONS

In addition to the ongoing congressional hearings and legislation, the Securities and Exchange Commission and other executive branch agencies are conducting individual investigations.

Securities and Exchange Commission

The securities laws are designed to protect investors from misrepresentation, deceit, and other fraudulent practices by requiring public disclosure of certain information by the issuers of securities. The Securities Act of 1933 requires a registration statement to be filed with the Securities and Exchange Commission (SEC) prior to a public offering of securities. The Securities Exchange Act of 1934 requires periodic reports and proxy materials to be filed with the SEC by registered companies.

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

The courts have not yet addressed the issue of whether and under what circumstances questionable payments made by a U. S. corporation to foreign officials would be material information

which should be publicly disclosed. Thus, the SEC, through its enforcement and voluntary disclosure programs, has been the sole judge of the materiality of such payments.

The SEC, through its enforcement program, is investigating questionable and illegal corporate payments and practices abroad for the following reasons: (1) bribes and kickbacks may involve falsification of accounting records, (2) the securities laws require companies to disclose material facts for investors to make informed investment decisions and to assess the quality of management, (3) corporate management and their advisors need to become fully aware of these problems and to effectively deal with them, and (4) to clarify its approach and authority in the area. The main thrust of the SEC's enforcement actions has been to restore the effectiveness of the system of corporate accountability and to encourage the boards of directors to exercise their authority to deal with the issue.

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

As the investigation progressed and the potential magnitude of the problem became apparent, the SEC sought to encourage voluntary corporate disclosure of the questionable or illegal foreign payments. Accordingly, the SEC advised companies with possible disclosure problems to (1) authorize an in-depth investigation of the questionable activities by a special independent review committee, (2) request the board of directors to issue an appropriate policy statement on transactions involving illegal or questionable activities in the United States or abroad, (3) consider whether interim public disclosure of the results should be made prior to completion of the investigation, and (4) report to the SEC on the final results of the investigation. In addition, the SEC is encouraging disclosure of the ongoing investigations in a current or annual report, registration statement, or other filing.

The SEC made an analysis of the public disclosures of questionable foreign and domestic activities of 89 corporations as of April 21, 1976. The results of this analysis were included in a special report (dated May 12, 1976),

prepared for the Senate Banking, Housing and Urban Affairs Committee. The report concluded that:

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

On January 26, 1977, the SEC announced a series of rulemaking proposals designed to promote the reliability and completeness of the financial information filed pursuant to the Federal securities laws. These proposals would require each issuer of securities to maintain (1) books and records accurately reflecting the transactions and dispositions of assets of the issuer, and (2) an adequate system of internal accounting controls designed to provide reasonable assurance that specified objectives are satisfied.

In order to protect the reliability of financial information and the integrity of the independent audit of issuer financial statements, the SEC is proposing rules which would explicitly prohibit (1) the falsification of an issuer's accounting records, and (2) the officers, directors, or stockholders of an issuer from making false, misleading or incomplete statements to an accountant engaged in an examination of the issuer.

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

Federal Trade Commission

The Federal Trade Commission (FTC) is trying to determine if Federal laws against unfair competition were violated by corporations making questionable payments abroad. Some believe that a corporation that makes payments may have an unfair competitive advantage, in violation of Federal law, over another corporation that does not make such payments. Although no charges have yet been made, the FTC inquiry is the first use of antitrust laws to combat the practice of making payoffs.

Internal Revenue Service

The Internal Revenue Code provides that bribes and kickbacks, including payments to government officials, cannot be deducted in computing taxable income if the payment (wherever made) would be unlawful under U. S. law if made in the United States.

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

The IRS has set up procedures to improve their effectiveness in detecting the misuse of corporate funds. Included are guidelines to detect schemes created for political contributions and bribery in the United States and abroad and techniques for examining "slush funds." Some of these guidelines call for (1) examining the books and records of American companies abroad, (2) examining international transactions of multinational corporations, and (3) working to strengthen cooperative efforts with nations with whom the United States has tax treaties. Under recent arrangements, the IRS will also be examining all SEC reports for issues having tax significance.

The major thrust of the investigations is to determine if any corporations have reduced their income taxes by deducting payoffs as expenses. If the IRS charges a corporation with such an act, its officers may face charges of (1) conspiring to violate Federal tax laws, (2) making a false return, and (3) giving a false statement to IRS agents. If it is determined that a company has committed tax fraud, the case will be forwarded to the Justice Department.

Department of Justice

Present Federal law does not prohibit, per se, bribery or similar questionable foreign payment practices by U. S. corporations in furtherance of commercial gain. However, criminal or civil liability may be incurred from collateral false reporting practices or by making false statements to a Federal agency.

APPENDIX

Amid reports and congressional hearings outlining extensive questionable payments by Lockheed to foreign officials, some of the affected governments have requested information on the Lockheed payments. Since December 1975, certain Lockheed documents on their foreign payment activities held by the U. S. Government have been under a court order limiting third-party access.

On March 5, 1976, Congress was told that the Department of Justice would develop cooperative arrangements with interested foreign governments to exchange information on the Lockheed payments. The information exchanged would be kept confidential unless used in a criminal prosecution. Subsequently, Japan, Italy, and several other countries have obtained copies of Lockheed documents through these "cooperative arrangements." The Subcommittee on Multinational Corporations of the Senate Foreign Relations Committee has released related Lockheed documents to the Justice Department for their transmittal to interested foreign governments.

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

Task Force on Questionable Corporate Payments Abroad

On March 31, 1976, President Ford established a 10-member cabinet-level task force, headed by Secretary of Commerce Elliot Richardson, to investigate overseas bribery by U.S. corporations. While the task force does not have any punitive or enforcement powers, it will seek to develop a comprehensive Government policy on the problem. The task force was instructed to come up with recommendations by the end of 1976.

President Ford sent a message to Congress on August 3, 1976, outlining his proposed "Foreign Payments Disclosure Act" (S. 3741, H.R. 15149). The bill is not limited to firms subject to SEC regulations, but applies to all U. S. participants in foreign commerce.

The proposed legislation would require reporting to the Secretary of Commerce on payments made "to any other individual

or entity in connection with an official action, or sale to or contract with a foreign government for the commercial benefit" of the individual, company, or foreign affiliate. By requiring reporting of all significant payments, whether proper or improper, the bill avoids the problems of definition and proof of bribery or extortion abroad.

Because of its late submission, the Administration's bill did not receive serious consideration before the congressional recess, but is expected to receive a full hearing in the next Congress.

In mid-January 1977, Secretary Richardson sent a memorandum to President Ford summarizing the task force's activities and accomplishments.

Department of Defense

The Defense Contract Audit Agency (DCAA) has been heavily involved in audits of improper transactions and sales agents fees through its responsibilities for insuring that improper and inappropriate costs are not reimbursed through Government contracts. Although DCAA has no investigative responsibilities, any irregular contractor activity found during an audit is reported to the appropriate military department or agency.

NON-GOVERNMENTAL ACTIONS

International Codes of Conduct

In early 1975, the 24-nation Organization for Economic Cooperation and Development (OECD) established a committee to draft a proposed code of conduct for multinational corporations. The code entitled "Declaration of OECD Member Governments on International Investment and Multinational Enterprises" was adopted by the OECD foreign ministers on June 21, 1976. The code (1) opposes the payment, solicitation or expectation of bribes by multinational corporations to foreign officials, (2) calls on business firms not to make political contributions, unless legally permissible, and (3) directs enterprises to abstain from any improper involvement in local activities. However, the code is not internationally enforceable and must depend on the cooperation of the multinational corporations.

The United Nations Commission on Transnational Corporations, a group of 48 nations reporting to the United Nations Economic and Social Council, has begun an investigation of the bribery issue. This inquiry was necessary since the OECD code, by and for the major industrialized nations, would not meet the expectations of non-industrialized third world nations.

On December 15, 1975, the United Nations General Assembly adopted a resolution to develop measures against corrupt practices of transnational or other corporations, their intermediaries and others involved. Among other things, the resolution (1) condemns all corrupt practices, including bribery, in violation of the laws and regulations of the host countries, (2) calls for intergovernmental cooperation to prevent corrupt practices and to prosecute violators, and (3) requests the Economic and Social Council to direct the Commission on Transnational Corporations to include in its program of work the question of corrupt practices of transnational corporations and, subsequently, recommend measures to prevent such corrupt practices.

Accounting Profession

The Auditing Standards Executive Committee of the American Institute of Certified Public Accountants issued two new "Statements on Auditing Standards" (SAS) in early 1977.

SAS No. 16, "The Independent Auditor's Responsibility for the Detection of Errors or Irregularities," discusses the auditor's responsibility for detecting errors or irregularities in an examination of financial statements in accordance with generally accepted auditing standards. It specifies that an independent auditor should plan his examination to include those auditing procedures that will provide a reasonable basis for believing that the financial statements, as a whole, are not materially misstated as a result of error or irregularity.

SAS No. 17, "Illegal Acts by Clients," sets forth guidelines for the appropriate conduct for an auditor where acts by a client, that appear to be illegal, come to his attention during an examination of financial statements. For example, if the illegal act is material to a company's financial condition and isn't properly accounted for or disclosed, the auditor should issue a qualified or adverse opinion.