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New Lockheed Policy to Prevent Questionable Foreign Marketing Practices. B-169300; PSAD-77-92. March 16, 1977. Released March 29, 1977. 8 pp. + appendix (13 pp.).

Report to Rep. William S. Moorhead, Chairman, House Committee on Banking, Finance and Urban Affairs: Economic Stabilization Subcommittee; by Elmer B. Staats, 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: Department of the Treasury; Department of Defense; Lockheed Aircraft Corp.
Congressional Relevance: House Committee on Banking, Finance and Urban Affairs: Economic Stabilization Subcommittee.
Authority: Anti-Kickback Act (41 U.S.C. 51-54). International Security Assistance and Arms Export Control Act of 1976 (P.L. 94-329). Tax Reform Act of 1976 (P.L. 94-455). Executive Order 9001. 10 U.S.C. 2206. 10 U.S.C. 2306(b). 10 U.S.C. 2313. 18 U.S.C. 431. 18 U.S.C. 433. 41 U.S.C. 22. 41 U.S.C. 254(a).

Lockheed Aircraft Corporation has taken several actions to remedy earlier management problems of money flowing to unauthorized individuals or organizations in connection with its foreign marketing activities. Findings/Conclusions: The new Lockheed policy and related procedures contain suitable control features over the company's own actions in foreign market dealings. However, there are certain external factors present in the foreign market which are beyond Lockheed's control, and, as such, the Lockheed actions alone will not necessarily preclude the possibility of money flowing to unauthorized foreign governmental, military, or customer officials. Lockheed established a Consultant Review Committee to review the qualifications of international consultants, which are individuals or firms engaged to provide marketing intelligence and marketing related services in foreign countries. The new policy sets out certain qualifications and limitations related to dealings with international consultants. The procedures have control features which provide for a separation of responsibilities and duties between officials proposing the use of consultants and officials approving the selections and payments. Payments to international consultants by all Lockheed divisions and subsidiaries require centralized approval. Lockheed has for the most part followed its new policy and procedures. (SC)

REPORT OF THE COMPTROLLER GENERAL OF THE UNITED STATES

New Lockheed Policy To Prevent Questionable Foreign Marketing Practices

Lockheed Aircraft Corporation

The new Lockheed policy and related procedures contain suitable control features over the company's own actions in foreign market dealings. However, because of factors beyond Lockheed's control, Lockheed actions alone will not necessarily prevent money from flowing to unauthorized foreign officials.

PSAD-77-92

MARCH 16, 1977

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

MARCH 16, 1977

B-169300

The Honorable William S. Moorhead
Chairman, Subcommittee on Economic
Stabilization
Committee on Banking, Finance
and Urban Affairs
House of Representatives

Dear Mr. Chairman:

On September 10, 1976, you requested that we comment on the actions taken by Lockheed Aircraft Corporation to remedy earlier management problems of money flowing to unauthorized individuals or organizations in connection with its foreign marketing activities. Our review was directed at determining (1) whether the recent management policy established suitable definitions of responsibility and proper safeguards within Lockheed to preclude the recurrence of the earlier problems, and (2) if the policy was effectively implemented by Lockheed management. Other aspects of Lockheed's foreign marketing practices concerning the impact on current and future sales due to public disclosure of certain foreign commission payments as well as the company's current ability to repay the Government-guaranteed loans, will be discussed in our annual report on the implementation of the Emergency Loan Guarantee Act.

Individuals or firms engaged by Lockheed to provide marketing intelligence and marketing related services in foreign countries are referred to as international consultants. We believe that the new Lockheed policy and related procedures contain suitable control features over the company's own actions in foreign market dealings. We want to point out, however, that there are certain external factors present in the foreign market which are beyond Lockheed's control and, as such, the Lockheed actions alone will not necessarily preclude the possibility of money flowing to unauthorized foreign governmental, military, or customer officials.

Lockheed established a Consultant Review Committee to review consultant qualifications. We noted, however, that this Committee did not perform reviews of certain consultants serving under agreements predating this new company policy. Lockheed stated that appropriate reviews had been made by their International

Marketing organization, but agreed to have the Committee review the qualifications of the consultants.

Lockheed has recently notified the Emergency Loan Guarantee Board that it may be in technical noncompliance with the policy on one recent consultant agreement which involved a commission payment of about $5,000. Lockheed advised the Board that action had been taken to remedy the situation.

In addition, one consultant may not have met the qualification criteria set out in the company policy and Lockheed is presently trying to determine the facts in this case.

With the additional reviews by the Committee and the other corrective actions taken, as cited above, we beleive that Lockheed's implementation of the new policy has been generally adequate.

BACKGROUND

In July 1975, Lockheed publicly disclosed that during the period January 1970 through June 1975, about $147 million was paid to international consultants. Lockheed officials stated that about $24 million is known or suspected to have been received by foreign officials and political organizations for their influence in securing the sale of Lockheed products in their countries. Since the disclosure of these payments, Lockheed's foreign marketing practices have been the subject of inquiries and investigations by the legislative and executive branches of the U.S. Government and by several foreign governments.

Shortly after disclosure of the consultant payments, Lockheed took action to institute more effective controls over the selection and use of international consultants. On October 6, 1975, the Lockheed Board of Directors established a policy with the objective of ensuring that Lockheed conducts its foreign activities in compliance with applicable United States and foreign laws. On October 16, 1975, the President of Lockheed issued a management policy statement providing for corporate review and approval of all international consultant agreements in accordance with the Board's policy.

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 new company policy could constitute an event of default on the part of Lockheed which could result in the 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.

POLICY CONTROL FEATURES

The policy sets out certain qualifications and limitations related to dealings with international consultants, including the following principal features:

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 United States 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.

The procedures have control features which provide for a separation of responsibilities and duties between officials proposing the use of consultants and officials approving the selections and payments. Selection of international consultants may be proposed by any Lockheed division or subsidiary.

Responsibility for approval rests with a Consultant Review Committee and a Senior Review Board at the corporate management level.

The Consultant Review Committee consists of three officials--one appointed by the Vice Chairman, Finance and Administration, another by the Vice President and General Counsel, and the third by the Vice President, International Marketing. The Committee is responsible for reviewing basic information on consultant qualifications as provided by the divisions and subsidiaries, and approving proposed selections if the established criteria are met.

The Senior Review Board is composed of the Senior Vice President, Marketing, the Vice Chairman, Finance and Administration, the Vice President and General Counsel, the President and Chief Operating Officer, and the Vice President, International Marketing. The Board is to review and resolve those matters which the Consultant Review Committee believes warrant higher level management attention. We found no specific criteria as to what is to be referred to the Board but we observed that the Board addressed such matters as consultant qualifications or proposed rates of compensation in some instances.

Payments to international consultants by all Lockheed divisions and subsidiaries require centralized approval. Initial payment under each basic consultant agreement requires approval by the Vice Chairman, Finance and Administration, the President and Chief Operating Officer, and the Chief or Assistant Chief Counsel. Subsequent payments to a consultant require approval by the Director of Administration, International Marketing.

Lockheed's policy qualifications and limitations, coupled with internal procedural controls, provide a reasonable degree of assurance that payments are made to duly authorized consultants in accordance with terms and conditions of consultant agreements. However, certain factors beyond Lockheed's control have a bearing on the possibility of money ultimately reaching unauthorized third parties.

The first factor to be considered is the amount of money that is paid to consultants for their services in securing sales for the companies they represent. The amounts paid are not controlled or determined by Lockheed alone, but rather by the 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. In the past, it has been 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 stop such practices.

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

It is possible that a greater degree of assurance of the ultimate disposition of commissions paid to consultants could be achieved through country-to-country agreements on ethical business practices and vigorous enforcement by participating countries. 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.

POLICY IMPLEMENTATION

Lockheed, for the most part, has followed the policy and procedures described earlier. As mentioned earlier, we did note that the Consultant Review Committee had not reviewed the qualifications of certain individuals or firms to determine their eligibility to serve as consultants in light of the policy criteria.

Selection and approval of consultants

We found that the Consultant Review Committee and the Senior Review Board performed adequate evaluations of consultant qualifications in 59 of 60 cases. In one case, file documentation indicated that a principal of the consultant firm also served as a government official of the country in which the service was to be rendered and which the products were to be sold. Written approval to serve in such dual capacity was not obtained. About $660,000 was paid to the consultant firm from October 1975 to July 1976, at which time the principal resigned from the consultant firm.

The Committee believed that the principal was a local official who would have had no influence in the sale of the

products involved to the national government and that the "dual capacity" approval was not required. Lockheed officials could not provide any evidence that the consultant was not an official of the national government. Lockheed officials advised us that they are presently attempting to determine whether the use of this consultant firm was in compliance with the policy.

We also found that the Consultant Review Committee did not determine whether 28 consultants, under agreements entered into prior to October 1975, complied with the qualifications set forth in the policy. At the time of our review, agreements with 14 of these consultants had lapsed or been terminated. Lockheed officials stated that reviews of consultant qualifications were made by their International Marketing organization rather than the Committee. During our review, however, we did not find adequate documentary evidence that such reviews were performed by International Marketing officials.

The Board of Directors' policy and the Lockheed management policy statement do not specifically require a retroactive review and approval of those consultants under pre-existing agreements. In our opinion, however, it seems reasonable that the Consultant Review Committee should have made a comprehensive evaluation to determine compliance with the policy in such cases. We reviewed files pertaining to the 28 consultants and found that:

--Two active agreements involve consultants identified by Lockheed as recipients of questionable payments of $1,273,000 prior to June 30, 1975. One of the consultants has received about $231,000 in commission payments since implementation of the policy. Lockheed's legal officials have received background information which they believe indicates that the firm receiving the $231,000 meets the policy qualifications and restrictions, and therefore, the commission payments are not improper or questionable. Such information will be provided to the Consultant Review Committee.

--One active agreement with a consultant firm (an airline corporation) provided for a commission on sales of Lockheed aircraft to the airline itself. The consultant agreement has not been amended to include the provisions of the new company policy on the selection and use of consultants. No commission payments have been made to this firm since the policy was established.

--Seven consultant agreement files did not contain basic information needed to determine whether the qualifications of the consultants were in compliance with the Lockheed policy. Agreements with four of these consultants are still in effect.

After bringing this matter to the attention of Lockheed officials, we were advised that the Consultant Review Committee will evaluate the qualifications of the 14 consultants currently being used by Lockheed under pre-October 1975 agreements.

Payments to consultants

We found that consultants receiving payments executed an amendment to the agreement incorporating provisions of the policy, and furnished a written certificate of compliance prior to each payment. Additionally, payment memoranda and copies of canceled checks showed that all disbursements were made to the order of the consultants. Approval procedures were adequately implemented to foster compliance with Lockheed policy.

With respect to approval of consultant payments, Lockheed advised you on September 8, 1976, that top level executive approval is required for key actions. We found that Lockheed was complying with implementing instructions in obtaining approval by top level executives for the initial payment to consultants. Although subsequent payments were only required to be approved by the Director of Administration, International Marketing, we believe the approval procedure provides adequate control over the payment process.

Voluntary disclosure of possible noncompliance

On January 21, 1977, Lockheed advised the Secretary of the Emergency Loan Guarantee Board that the company may be in technical noncompliance with its policy on the selection and use of international consultants. The disclosure involves a $5,000 payment on December 29, 1976, for services rendered in connection with the possible sale of used aircraft, including maintenance and related services, to a foreign airline.

Lockheed stated that the consultant agreement dated October 12, 1976, was not approved by corporate counsel, and did not include certain provisions required by the policy statement restricting the use of consultant payments.

Lockheed considers the matter of minor importance and not a violation of the spirit or intent of the policy statement since there was no payment to a government or customer official. The company advised the Board that action has been undertaken to (1) amend the agreement to conform with the policy statement requirements, and (2) obtain a written certification from the consultant that payments were not made to third parties, and that performance under the agreement complied with laws of the United States and the foreign country.

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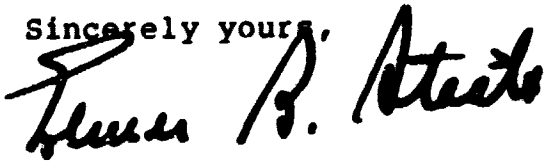
We believe that Lockheed's questionable foreign marketing practices are symptomatic of similar actions by many other American corporations. We also believe it is a serious problem and have set forth, for your information, the major initiatives currently underway dealing with this subject. (See Appendix.)

The results of our review were discussed with Lockheed officials and a copy of our draft report was provided to company officials for review and comment as agreed to by your staff. Since matters presented in this report may be of interest to the Emergency Loan Guarantee Board, we will contact your staff to request release of the report to the Board.

Sincerely yours,



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. 18.)

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. 20.)

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. 19.)

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.

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, as 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.