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# Expansion of SEC Authority into Internal Corporate Governance: The Accounting Provisions of the Foreign Corrupt Practices Act (A Twentieth Anniversary Review)

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## Cover Page Footnote

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# EXPANSION OF SEC AUTHORITY INTO INTERNAL CORPORATE GOVERNANCE: THE ACCOUNTING PROVISIONS OF THE FOREIGN CORRUPT PRACTICES ACT (A TWENTIETH ANNIVERSARY REVIEW)

KATHLEEN A. LACEY*

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## I. INTRODUCTION

To strengthen the antibribery provisions of the Foreign Corrupt Practices Act of 1977 (FCPA or the original Act),[1] Congress included provisions in the original Act, and in later amendments, requiring recordkeeping and internal accounting controls. These accounting

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1. Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, tit. I, 91 Stat. 1494 (1) codified at 15 U.S.C. §§ 78a, 78m, 78dd-1, 78dd-2, 78ff (amending scattered sections of the Securities Exchange Act of 1934, 15U.S.C.§§ 77a-78kk (1976).

sections significantly extended the authority of the Securities Exchange Commission (SEC or Commission) beyond traditional disclosure requirements of the 1933 Securities Act (1933 Act)[2] and the 1934 Securities Exchange Act (1934 Act).[3] The FCPA granted the SEC authority over the entire financial management and reporting requirements of those corporations subject to SEC regulation. On the FCPA's twentieth anniversary, expansion of the SEC's authority remains a source of concern for the business community because it is a potential tool for extensive federal intrusion into internal corporate affairs.

The authors view this as an appropriate opportunity to: (1) review the relevant political and accounting background during the years preceding the passage of the amended Act in 1988; (2) evaluate the statutory language of the FCPA and its later amendments as a basis for the increased powers of the SEC in internal corporate management, including a brief history of the SEC's policy shift from a mandatory disclosure system to a direct legislative intrusion into corporate management; (3) analyze relevant cases and SEC enforcement actions to determine the level of judicial support for the SEC's expanded internal corporate governance role; and (4) demonstrate the manner in which the SEC wields its increased authority through application of the accounting and auditing standards.

In their conclusion, the authors advise the business community to remain alert because there is statutory, regulatory, and judicial authority for the SEC to use its expanded authority in the area of internal corporate financial management. The current increase in the SEC's prosecution of antibribery violations[4] may serve as the predictor for an increase in the enforcement of the accounting provisions of the FCPA, with its attendant focus on SEC intrusion in internal corporate governance.[5]

## II. BACKGROUND

The main purpose for adopting the FCPA was elimination of corrupt business practices, specifically corporate bribery of foreign government officials to obtain contracts.[6] In order to achieve this

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2. Securities Act of 1933, 15 U.S.C. § 77a (1988).
3. Securities Exchange Act of 1934, 15 U.S.C. § 78a (1988).
4. The SEC's current Associate Director of Enforcement, Paul Gerlach, has stated, "While we have not brought a lot of cases in the recent past, there will be more in the future." *See* Dominic Bencivenga, *Anti-Bribery Campaign: SEC Cracks Down on Illegal Payments Abroad,* N.Y.L.J. 5 (1997).
5. *See* SEC v. Triton Energy Corp., C.A. No. 1:97CV00401 (D.D.C. 1997).
6. *See* 15 U.S.C. §§ 78dd-1, 78dd-2 (1988).

goal, Congress also included accounting provisions in the original Act, which regulate corporate financial recordkeeping and internal control systems.[7] Unlike the antibribery sections, the accounting provisions were passed as amendments to the 1934 Act and therefore apply to covered corporations regardless of whether they are engaged in foreign business or are a solely domestic operation.[8]

The two accounting provisions of primary importance in the original Act are section 13(b)(2)(A) which established recordkeeping requirements by mandating that all corporations "make and keep books, records, and accounts, which in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer"[9] and section 13(b)(2)(B), which required corporations to "devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances" that transactions and assets are properly maintained.[10]

The SEC exercised its expanded authority from the FCPA accounting provisions by promulgating two rules that created liability for corporations and individuals who falsify accounting records or make materially false statements to an outside auditor.[11]

Judicial support for this expansion of SEC authority was provided in the case of *SEC v. World-Wide Coin Investment, Ltd.* in 1983.[12] Because so few cases have been litigated on the accounting provisions, the *World-Wide Coin* case provides the only example of judicial interpretation of the original Act prior to its amendment in 1988. Most of the other cases have been resolved prior to trial by consent decree or other settlement; therefore, *World-Wide Coin* provides an important precedent.

The *World-Wide Coin* case was one of many factors[13] instrumental in influencing Congress to amend the FCPA in the 1988 Omnibus Trade and Competitiveness Act.[14] This act made three major changes in the accounting provisions: First, the terms "reasonable assurances" and "reasonable detail" were clarified to mean "such level of detail and degree of assurance as would satisfy prudent

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7. *See* 15 U.S.C. § 78m(b)(2)(A) (1988).
8. *See* 15 U.S.C. § 78m(b)(2) (1988).
9. 15 U.S.C. § 78m(b)(2)(A) (1988).
10. 15 U.S.C. § 78m(b)(2)(B) (1988).
11. *See* 17 CFR § 240.13b2-1 (1991); *see also* 17 CFR § 240.13b2-2 (1991).
12. SEC v. World-Wide Coin Investment, Ltd., 567 F. Supp. 724 (N.D. Ga. 1983).
13. *See, e.g.*, the GAO Report requested by Congress to investigate the impact of the FCPA on U.S. businesses. U.S. GENERAL ACCOUNTING OFFICE, REPORT TO THE CONGRESS: IMPACT OF FOREIGN CORRUPT PRACTICES ACT ON U. S. BUSINESS (1981) [hereinafter GAO REPORT].
14. Pub. L. No. 100-418, 102 Stat. 1107 (1988) (codified in scattered sections of 15 U.S.C. (1988)) [hereinafter Trade Act].

officials in the conduct of their own affairs."[15] This amendment was of greatest concern to SEC registrants due to the inherent ambiguity of the terms "reasonable" and "prudent,"[16] and an uncertainty as to how the courts may interpret the meaning of those terms.[17] Second, the "reason to know" standard as a basis of liability was deleted and replaced with a statement that "no person shall knowingly circumvent or knowingly fail to implement a system of internal accounting controls or knowingly falsify any book, record, or account."[18] Last, an added provision defined the differing responsibilities for the owners of majority and minority interests in foreign subsidiaries. A minority owner is only required to "proceed in good faith to use its influence" to cause its subsidiary "to devise and maintain a system of internal accounting controls."[19]

Overall, the amendments placed insignificant constraints on SEC authority. Some restriction on authority results from the provision relating to the differing responsibilities between majority and minority ownership of a foreign corporation because it has reduced the pool of corporations subject to the FCPA.

The FCPA and its 1988 amendments provide an example of the expanding focus of the SEC. The focus changed from the traditional, noninterventionist approach of merely requiring disclosure under authority granted to it by the 1933 and 1934 Acts to forthright intrusion into internal corporate affairs.

## III. SEC POLICY SHIFT FROM A REGULATORY SYSTEM BASED SOLELY ON DISCLOSURE

Through the FCPA, Congress intentionally allowed the SEC to go far beyond the disclosure function. The statute granted the SEC new rulemaking and enforcement authority over the internal control and recordkeeping mechanisms of its registrants.[20]

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15. 15 U.S.C. § 78m(b)(7) (1988).

16. *Id.*

17. The courts rely on the relevant accounting and auditing standards in their interpretation of the "reasonable detail" and "reasonable assurance" requirements. The SEC and the companies they regulate also use the standards to achieve and evaluate FCPA compliance.

18. 15 U.S.C. § 78m(b)(5) (1988).

19. 15 U.S.C. § 78m(b)(6) (1988).

20. *See* Daniel L. Goelzer, *The Accounting Provisions of the Foreign Corrupt Practices Act—The Federalization of Corporate Recordkeeping and Internal Control*, 5 J. CORP. L. 1 (1979).

### A. History of the Disclosure System Based on the 1933 and 1934 Securities Acts

As a result of strenuous objections from business, Congress chose in 1933 not to embody the concept of substantive regulation as a means of investor protection.[21] In recommending passage of the 1933 Act,[22] President Roosevelt emphasized that the legislation's purpose was to "protect the public with the least possible interference to honest business."[23] From the 1930s, federal securities law was based on the philosophy that market efficiency is enhanced by the disclosure to investors of relevant material facts.[24]

The 1933 and 1934 Acts were based upon the market principle that investors are protected, with a minimum of government intervention, through an open market system that values securities at their fair price. An open market was achieved by providing means to disclose material information to investors and shareholders so that they can make informed decisions.

When Congress adopted the disclosure approach, there was a mandate to the SEC that substantive regulation of business was beyond the SEC's statutory discretion.[25] The materiality standard[26] which determines when omitted or misstated securities disclosures are actionable,[27] prevented undue interference in internal corporate

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21. In 1933 Felix Frankfurter described the purpose of the 1933 Act as seeking "[t]o build on self discipline by all agencies engaged in marketing securities by compelling full publicity of 'every essentially important element attending the issue of new securities' so that the public may have an opportunity to understand what it buys" Felix Frankfurter, *The Federal Security Act*, FORTUNE, Aug. 1933, at 53. It should be noted that Justice Louis Brandeis had advocated a full disclosure model but the Securities Act of 1933 was a political compromise worked out by Frankfurter, who was than a professor at Harvard Law School. ROBERTA KARMEL, REGULATION BY PROSECUTION 40-41 (1982).

22. Securities Act of 1933, 15 U.S.C. § 77a (1988).

23. KARMEL, *supra* note 21, at 42.

24. There have been numerous detractors to the mandatory disclosure system theory, including Homer Kripke, a former SEC Commissioner, in his book, THE SEC AND CORPORATE DISCLOSURE: REGULATION IN SEARCH OF A PURPOSE (1979). In the 1977 report of the SEC's Advisory Committee on Corporate Disclosure, inspired by the critics of the disclosure system, the Committee decided that it was "sound and does not need radical reform or renovation." REPORT OF THE ADVISORY COMMITTEE ON CORPORATE DISCLOSURE TO THE SECURITIES AND EXCHANGE COMMISSION, 95th Cong., lst Sess., Comm. Print 95-29 quoting cover letter, 2 (1977). *See* JOEL SELIGMAN, SEC & THE FUTURE OF FINANCE 196 (1985).

25. Note, *The Accounting Provisions of the Foreign Corrupt Practices Act: An Alternative Perspective on SEC Intervention in Corporate Governance*, 89 YALE L.J. 1573, 1582 (1980).

26. It is interesting to note that in the original FCPA, and its subsequent amendment in 1988, Congress has refused to incorporate a materiality standard in the statutory language.

27. Materiality in regard to financial and accounting disclosure is defined as follows: "the magnitude of omission or misstatement that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement." *See* Financial Accounting Standards Board, Statement of Financial Accounting Concepts No. 2, *Qualitative Characteristics of Accounting Information* (1980).

affairs and limited the extent of the SEC's discretionary authority in internal corporate governance under the 1933 and 1934 Acts.[28]

### B. SEC Reexamination of the Disclosure System

A subtle shift in the SEC's philosophy underlying the disclosure system began taking place during the 1960s. There were two key cases during that decade, *In re Cady Roberts & Co.*[29] in 1961 and *SEC v. Texas Gulf Sulphur Co.*[30] in 1968.

#### 1. Key Cases Reflecting the Shift in SEC Philosophy

SEC Chairman William Cary decided to apply Rule 10b-5 to pursue inside traders in the *Cady Roberts* case.[31] The concept that there should be liability for misuse of information available to insiders but not available to the investing public, was followed a few years later by SEC Chairman Cohen in the *SEC v. Texas Gulf Sulphur Co.* case.[32] The *Texas Gulf Sulphur* case represented an approach by the SEC that not only securities industry professionals, but also investors, could owe a general duty to the marketplace. The SEC eventually extended the duty regarding inside information to those who were not even stockholders in the corporation.[33]

#### 2. Securities Acts Amendments, 1964

The SEC increased its regulation of corporations through passage of legislative amendments. The Securities Acts Amendments of 1964, known as the Frear-Fulbright Bill, which extended disclosure and insider trading protection to the over-the-counter markets, strengthened standards and qualifications for securities firms and tightened the Commission's disciplinary controls.[34]

### C. Additional Pressures to Alter the Disclosure System

There was debate regarding the effectiveness of the disclosure system since the enactment of the Securities Act of 1933.[35] The first of a series of articles by University of Chicago economist George Stigler in 1964 raised the level of questions about the disclosure

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28. Note: *Accounting Provisions of the Foreign Corrupt Practice Act*, *supra* note 25, at 1583.
29. *In re* Cady Roberts & Co., 40 S.E.C. 907 (1961).
30. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969).
31. *See* Cady Roberts, *supra* note 29.
32. Texas Gulf Sulphur Co., 401 F.2d at 833.
33. *See* KARMEL, *supra* note 21, at 59.
34. *See* 50 YEARS OF THE U. S. SECURITIES AND EXCHANGE COMMISSION 40 (1984).
35. Securities Act of 1933, 15 U.S.C. § 77a (1988).

system to a point where elimination of the system was demanded because of the negative effect on business.[36] The basic premise was that a mandatory corporate disclosure system is unnecessary because corporate managers possess sufficient incentives to voluntarily disclose all, or virtually all, information which is material to investors.[37]

On the other hand, there were forces from the other side of the political spectrum that argued to change or eliminate the disclosure system by increasing government control over internal corporate governance. Corporate boards of directors were attacked for their failure to protect the interests of investors because they did not properly oversee the operation of the business and, in many cases, were simply management puppets.[38]

*1. The Consumer Movement*

The adequacy of the disclosure system as a means of consumer protection became an issue during the era of consumerism in the late 1960s. During that period, Ralph Nader became a name synonymous with consumer protection. He was a leading advocate of the idea of "corporate social responsibility." Congress passed the Consumer Product Safety Act[39] in 1972 and a new federal independent regulatory agency was created, the Consumer Product Safety Commission. The Federal Trade Commission Improvement Act[40] was passed in 1975 granting broad powers to the Federal Trade Commission.

These events coincided with, and were partly related to, the Watergate scandal. A natural environment was created to evaluate the issue of the extent to which a passive system of disclosure protects an investor. Indeed, it was Ralph Nader and some of his associates[41] who demanded increased protection for investors. They felt that the controls of the disclosure system, intended to ensure that corporations efficiently and responsibly serve the public interest, had not prevented irresponsible and unlawful conduct by corporate executives.[42] Mr. Nader and his associates complained that there was no system of accountability to govern the actions of large,

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36. George Stigler, *Public Regulation of the Securities Markets*, 37 J. BUS. 117 (1964).

37. *See* SELIGMAN, *supra* note 24, at 197.

38. *See* MYLES MACE, DIRECTORS: MYTH AND REALITY at 3 (1971). *See* SELIGMAN, *supra* note 24, at 537.

39. Pub. L. No. 92-573, 86 Stat. 1207, 15 U.S.C.A. § 2051 (1972).

40. Pub. L. No. 93-637, 88 Stat. 2183, 15 U.S.C.A. § 2301 (1975) and several other acts.

41. *See* SELIGMAN, *supra* note 24, at 545 . Mr. Seligman notes in his book that he was one of Mr. Nader's associates.

42. *See* KARMEL, *supra* note 21, at 141.

multinational corporations that were sometimes described as "private governments."[43]

2. *Proposed Federal Incorporation Statute*

One potential method of protecting investors from corporate boards operating as arms of management was Nader's proposed federal chartering of corporations which "would restructure the board of directors, redefine its relationships with management, employees, and shareholders, and regulate corporate disclosure and conduct in certain significant areas of social concern."[44]

The era of concentration on corporate accountability had arrived. The series of events that best illustrated the deficiencies of the corporate board of directors were the SEC questionable payment cases arising out of Watergate. Mr. Nader and his associates proposed the federal incorporation of all industrial, retail, and transportation firms with sales of $250 million or more that employed ten thousand or more persons.[45] It was proposed that each of the firms would have full-time directors and the directors would be nominated only by impartial shareholders.[46] Each director could be nominated only by shareholders not affiliated with the firm's internal managerial staff. A controversial aspect of the proposal was the incorporation of corporate social responsibility ideas, making it the board's duty to be involved in matters connected with "employee welfare," "consumer protection," or "management efficiency."[47]

Congressional hearings were held in 1976 and 1977 regarding the need for a new federal corporate law.[48] Also, the Commission held public hearings in 1977 dealing with corporate governance in which the SEC was trying to determine the extent of erosion of corporate accountability through abuse of power or management misconduct.

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43. *See id.*

44. RALPH NADER, ET AL., TAMING THE GIANT CORPORATION (1976). *See* KARMEL, *supra* note 21, at 141.

45. *See* SELIGMAN, *supra* note 24,at 545.

46. *See id.*

47. *See id.*

48. *Corporate Rights and Responsibilities Hearings, Senate Commerce Comm.*, 94th Cong., 2nd Sess. (1976); and *The Role of the Shareholder in the Corporate World Hearings, Senate Judiciary Subcomm. on Citizens and Shareholder Rights and Remedies*, 95th Cong., 1st Sess. (1977). *See* SELIGMAN, *supra* note 24, at 545 n.312. The momentum toward a federal statute to set minimum standards for corporate law was lost when President Jimmy Carter appointed Harold Williams in 1977 as the SEC chairman and Roberta Karmel as a commissioner. Because both Williams and Karmel were opposed to such a federal statute, it may seem contradictory that Chairman Williams was in fact in favor of the SEC's thrust toward increased corporate accountability. The SEC, during William's tenure, held public hearings concerning a number of investor issues, including corporate governance. *See* KARMEL, *supra* note 21, at 143, 145.

Despite their public criticisms of corporate boards of directors, both SEC Chair Roderick Hills, and subsequently Chairman Williams, opposed the idea of federal corporate governance legislation.[49]

The result of the hearings was that in 1978 the SEC adopted a rule which included requirements that registered firms disclose additional information on the independence of their directors, the existence of any audit, nomination, or compensation committees, and information about the attendance record of board members.[50] Congress did not pass any legislation in this area.

*3. Proposed Federal Minimum Standards for State Corporate Laws.*

In 1974, parallel with the activities of the consumer activists and the proponents of a federal chartering system, SEC Chair William Cary proposed that Congress enact federal minimum standards for state corporate laws.[51] The intent was to forestall states, like Delaware, from using lenient incorporation laws as a way of generating revenue.

The proposed federal statute established standards of officer and director conduct for all firms above a minimum size.[52] The adoption of the proposal would have permitted shareholder suits against corporate directors who approved any transaction unfair to their firm or otherwise failed to observe their fiduciary duties.[53]

*4. The Watergate Scandal*

The disclosure of corporate wrongdoing during the Nixon crisis roused public interest and anger over the blatant acts of illegal campaign contributions and foreign bribery. A Special Watergate Prosecutor was selected to investigate the alleged illegal payments.

The investigations of the Special Prosecutor discovered a widespread practice by multinational American corporations of funneling moneys through foreign agents. These moneys were used to establish unrecorded slush funds for domestic political contributions in violation of campaign finance law, and to bribe foreign officials to obtain favorable contracts. Twenty-five of America's largest companies were identified as giving illegal campaign contributions to President Richard Nixon.[54] The investigation of the illegal campaign

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49. *See* SELIGMAN, *supra* note 24, at 547, 549.
50. *See* Exchange Act Release No. 15,384 (1978). *See* KARMEL, *supra* note 21, at 162, 550.
51. *See* SELIGMAN, *supra* note 24, at 544.
52. *See id.*
53. *See* William Cary, *Federalism and Corporate Law: Reflections on Corporate Responsibility*, 83 YALE L.J. 663 (1974); SELIGMAN, *supra* note 24, at 544.
54. *See* G. GREANIAS & D. WINSOR, THE FOREIGN CORRUPT PRACTICES ACT 22 (1982).

contributions led to the discovery that scores of other companies were taking part in other bribery schemes, both domestically and internationally.[55]

One incident that received significant media attention concerned the activities of Lockheed Aircraft Corporation. Lockheed was involved in an extensive and far-reaching scheme amounting to approximately $202 million paid in bribes to politicians and sales agents in the United States and foreign government officials abroad. In addition to the Nixon campaign, Lockheed paid bribes of more than one million dollars to Prince Bernhard, the husband of Queen Juliana of the Netherlands, $1.7 million to former premier of Japan Kakeui Tanaka, over $7 million to politically connected right wing Japanese militarist Yoshio Kodama, $2 million to Italian officials, and scores of lesser amounts to about eight different countries, including Germany, Mexico, Spain, and Greece. In 1971, Congress had authorized a $250 million loan guarantee to prevent Lockheed from going into bankruptcy. Although Congress was divided on the merits of the loan guarantee assistance, the loan never would have been approved if Congress had been aware that the projected sales figures depended on bribes to foreign officials.[56]

This disclosure of extensive corporate wrongdoing by Lockheed and other major companies provided the motivation for Congress and the SEC to fully examine the scope of illicit payments.

### *D. The SEC's Voluntary Disclosure Program, 1975*

Public concern about corporate impropriety ran high and provided the environment for federal intervention.[57] The enforcement activities in 1974 of Stanley Sporkin, head of the SEC's recently created Enforcement Division, were paramount in setting the stage for the interventionist approach subsequently taken by Congress in the accounting provisions of the FCPA.[58]

Mr. Sporkin discovered the bribery of foreign companies while investigating Nixon's illegal corporate campaign contributions. Sporkin, a CPA as well as an attorney, became interested in investigating the extent of corporate bribery while watching the Watergate hearings on slush funds created by undisclosed transactions being

55. *See* John F. Berry & William H. Jones, *Boxes of Boxes of SEC Documents Reveal Secret Dealings*, WASH. POST, May 18, 1977, at A1.

56. *See* Michael Ruby et al., *How Clean Is Business?*, NEWSWEEK, Sept. 1, 1975, at 50. *See* Barbara C. George & Mary J. Dundas, *Responsibilities of Domestic Corporate Management Under the Foreign Corrupt Practices Act*, 31 SYRACUSE L. REV. 868 n.6 (1980).

57. *See* SELIGMAN, *supra* note 24, at 545.

58. *See* 50 YEARS OF THE U. S. SECURITIES AND EXCHANGE COMMISSION 64 (1984).

used to finance illegal campaign contributions.[59] This led him to establish a voluntary disclosure program to examine the size of the slush funds and the type of payments made.[60] This voluntary disclosure program allowed firms to avoid enforcement action by conducting their own investigation of questionable or illegal payments, using nonemployee directors or independent outside counsel.[61] In exchange for voluntary compliance, the commission agreed not to prosecute those issuers who made reports of investigations into sensitive payments.[62]

Approximately six hundred corporations voluntarily disclosed acts of domestic and foreign bribery, falsification of records, and illegal campaign contributions.[63] The voluntary disclosures revealed that enormous amounts of funds in some of the largest and most prestigious corporations were being used to bribe foreign businesses in order to obtain contracts.[64]

Ironically, it was this use of a voluntary disclosure system that provided the basis for a shift from the federal mandatory disclosure system to increased federal intervention in corporate governance. The prevalence of bribery and other illegal payments within so many corporations caused the issue of corporate accountability to come to the forefront.

The questionable payment revelations were first viewed by the SEC as an issue regarding the adequacy of the disclosure system.[65] With the pressure of public and Congressional concern over questionable payments, and the pressures to adopt a federal corporation statute, the SEC attitude changed and emphasis was placed on the issue of corporate accountability. The SEC Chairman at that time, Roderick Hills, conceded that "there should be little question that there is a profound and pressing need to seek ways to raise the levels of conduct of corporate management."[66]

*E. The Securities and Exchange Commission's Report on Questionable and Illegal Corporate Payments and Practices, 1976*

Congress was subjected to intense public pressure to take some action due to the extraordinary press coverage of all the developing

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59. *See id.* Note that Stanley Sporkin was described by former general counsel, Harvey Pitt, as the "SEC's Columbo."

60. *See id.*

61. *See id.*

62. *See* KARMEL, *supra* note 21, at 149.

63. *See* 50 YEARS OF THE U. S. SECURITIES AND EXCHANGE COMMISSION, *supra* note 34.

64. *See* RUBY, *supra* note 56.

65. *See* SELIGMAN, *supra* note 24, at 545.

66. *Id.* at 546.

events regarding the bribery and illegal contributions. The public reacted with shock and distaste at every new exposure of corporate deviousness and misconduct. The Senate Committee on Banking, Housing, and Urban Affairs began hearings in 1975 on illegal foreign payments.[67] Congress asked the SEC, which had instituted the voluntary disclosure program[68] for companies engaged in bribery, to compile a report on American business practices abroad.

The Securities and Exchange Commission's Report on Questionable and Illegal Corporate Payments and Practices (SEC Report) in 1976 recommended that Congress enact accounting safeguards.[69] The surprising information obtained during the SEC's inquiry was how well it could be documented that companies were falsifying their books and records, with knowledge and indirect involvement reaching to the top echelons of management. Questionable practices such as unrecorded transactions, falsified records, and misrepresentations were reported. These practices manifested themselves in questionable business transactions such as

> (1) the "accumulation of funds outside the normal channels of financial accountability" within the discretion of a few executives who were not held accountable, (2) the use of "non-functional subsidiaries and secret bank accounts" to hide the true source of funds used for illegal payments and (3) various methods of disguising the source of funds used for illicit payments.[70]

The 1976 SEC Report provides some background for the future motivation of Congress to pass the accounting provisions of the FCPA. Importantly, the drafters of the SEC Report were affected by the recommendations for federal minimum standards for state regulation and the proposal for federal incorporation and were affected by the Congressional hearings on those subjects. The drafters thus determined that, although deterrence of corporate bribery is important, the most significant goal for future legislation should be the establishment of a system of controls ensuring general corporate accountability.[71]

The SEC Report states that the information about the form of the widespread questionable and illegal corporate payments had "cast doubt on the integrity and reliability of the corporate books and

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67. 94th Cong., 1st Sess. (1975).

68. *See SEC Offers Amnesty in Corporate Payoffs*, BUS. WEEK, Aug. 4, 1975, at 20.

69. *See* SECURITIES AND EXCHANGE COMMISSION, REPORT TO THE SENATE COMM. ON BANKING, HOUSING, AND URBAN AFFAIRS, 95th Cong., 2d Sess., QUESTIONABLE AND ILLEGAL CORPORATE PAYMENTS AND PRACTICES (COMM. PRINT 1976) [hereinafter SEC REPORT].

70. *See id.* at 23-24.

71. *See* GAO REPORT, *supra* note 13, at 70-71.

records that are the very foundation of the disclosure system established by federal securities laws."[72] One can conclude from that language that the Commission felt the abuses in recordkeeping and internal control systems were so endemic to corporate culture that the SEC needed the ability to exercise more direct authority over internal corporate affairs in order to prevent such improper conduct.

The SEC Report referenced the role of audit committees, comprised of directors independent of management, in uncovering falsification of corporate records[73] and strongly recommended independent audit committees as an appropriate part of the structure of boards of directors.[74] The SEC Report concluded that:

> Despite the troubling aspects of the information concerning past questionable or illegal payments, the Commission believes that there is a considerable basis from which to conclude that the episodes may serve to strengthen the quality of corporate management and public confidence in business over the long run. The optimism rests both on the declarations of cessation, already mentioned, and, more fundamentally, on the "new governance" concept that the commission's enforcement and disclosure programs are attempting to instill and its legislative and other proposals are designed to enhance.[75]

It is clear that the SEC feared that the lack of corporate accountability undermined the disclosure premise upon which the securities laws then rested.

### *F. Effect of SEC Report on Prospective Statutory Language*

The SEC Report significantly affected Congressional formulation of the FCPA. It proved to be one of the main reasons for the inclusion of the accounting provisions, which are amendments to the 1934 Exchange Act, and applicable to both domestic and foreign corporations. The SEC Report revealed to Congress "a breakdown in the system of corporate accountability" which was a "matter of concern irrespective of any bribery or questionable payments."[76]

It was obvious to Congress that it must address the issue of imposing statutory duties on corporate board members that would require corporate management to assume direct responsibility for the recordkeeping and internal accounting control systems of the

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72. SEC REPORT, *supra* note 69, at 49-50.
73. *See id.*
74. *See* KARMEL, *supra* note 21, at 52.
75 SEC REPORT, *supra* note 69.
76. GAO REPORT, *supra* note 13, at 70.

corporation. By encouraging the boards of directors to exercise their authority, "the efficacy of the system of corporate accountability" would be restored.[77] The SEC Report concluded that "[t]he almost universal characteristic of the cases reviewed to date by the Commission has been the apparent frustration of our system of corporate accountability."[78] Thus, with the impetus of the revelations in the SEC Report as to the involvement of top level management in corrupt conduct, Congress acted to prevent corporate board members from turning a blind eye to improper accounting practices. In the 1976 SEC Report, the Commission recommended adoption of specific recordkeeping language, which was enacted into legislation a year later in the accounting provisions of the FCPA.

## IV. PASSAGE OF THE FCPA, 1977

Congress passed the FCPA with unusual speed and surprising unanimity. It included, as expected, both antibribery provisions and accounting provisions. A rather complicated two-track system was created.[79] The accounting provisions of the FCPA were passed as a part of a series of amendments to the Securities Exchange Act of 1934.[80] Unlike the antibribery portions of the Act covered in sections 103[81] and 104[82] of the Securities Exchange Act of 1934, the accounting provisions in section 102[83] apply only to "issuers" registered under the Securities Exchange Act of 1934. Therefore, Section 102 applies to all corporations covered by the 1934 Act and companies engaged solely in domestic businesses as well as those engaged in international business. Thus, as one writer has described it, an American company does not have to be either foreign or corrupt to come within the scope of these sections.[84]

The provisions represent an attempt to address the overall problem of corporate concealment of illicit payments often disguised through improper accounting procedures by companies within the jurisdiction of the SEC. The provisions reflect the ideas that first appeared in the 1976 SEC Report: that although deterrence of corporate bribery is an important goal, the most important goal is to

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77. SEC REPORT, *supra* note 69.
78. *Id.*
79. *See* 15 U.S.C. § 78 (1976 & Supp. IV 1980).
80. 15 U.S.C. § 78m(b)(2) (1988).
81. 15 U.S.C. §§ 78dd-1 & 78dd-2 (1988).
82. 15 U.S.C. § 78dd-2 (1988).
83. 15 U.S.C. § 78m(b)(2) (1988).
84. *See* LAMBERT SPRONK, THE FINANCIAL EXECUTIVE HANDBOOK FOR MANAGING MULTINATIONAL CORPORATIONS 264 (1980).

establish a system of controls to ensure general corporate accountability.[85]

### *A. Statutory Language Which Expanded the Role of the SEC*

Pursuant to these objectives, the law passed in 1977 required every issuer of registered securities to:

> 1. Make and keep books, records, and accounts which, *in reasonable detail*, accurately and fairly reflect transactions and dispositions of assets.
>
> 2. Devise and maintain a system of internal accounting controls sufficient to provide *reasonable assurances* that transactions are executed in accordance with management's general or specific authorization; transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles, or any other applicable criteria, and to maintain accountability for assets; access to assets is permitted only in accordance with management's general or specific authorization; and the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.[86]

It was predicted that "the consequence of adding substantive requirements governing accounting control to the federal securities laws may significantly augment the degree of federal involvement in the *internal management of public corporations* (emphasis added)."[87] Legislative history indicates that an important factor in enactment of the FCPA was "a desire to protect the investor, as was the purpose behind the enactment of the Securities Acts."[88]

### *B. Enforcement and Penalties*

The FCPA divides enforcement authority between the Department of Justice and the SEC. The SEC has the authority to investigate and civilly prosecute violations of both the accounting and antibribery provisions of the FCPA with regard to issuers.[89] The Department of Justice is responsible for criminal enforcement of the antibribery provisions[90] (often based on evidence gathered by a SEC

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85. *See* GAO REPORT, *supra* note 13, at 70-71.

86. 15 U.S.C. § 102 imposes these requirements on every company having a class of securities registered pursuant to section 12 of the 1934 Act and every company required to file regular disclosure reports under section 15(d) of the 1934 Act.

87. *Id.*

88. SEC REPORT, *supra* note 69.

89. *See* 15 U.S.C. §§ 78dd-2(d), 78dd-1, 78ff-2(c) (1988).

90. *See* 15 U.S.C. § 78dd-1 (1988).

investigation) and for civil enforcement against domestic concerns.[91] Under the original Act, the provision known as the Eckhardt Amendment allowed the Department of Justice and the SEC to proceed against a corporate employee only if the corporation itself had been found guilty.[92]

Those convicted of violations under the accounting and recordkeeping provisions are subject to the penalties for violations of the 1934 Act generally.[93] The first penalty pertinent to the recordkeeping provisions states that any person who willfully violates a section of the 1934 Act may be fined no more than ten thousand dollars.[94] Second, a person who willfully violates a provision of the 1934 Act, including the accounting provisions, may be imprisoned for no more than five years.[95] A convicted person could possibly be liable for both penalties and be imprisoned for some time period. Third, corporations convicted of willful violations are subject to a fine not to exceed one million dollars.[96] Fines imposed on corporate officers and directors may not be paid directly or indirectly by their companies.[97] Therefore, companies can not indemnify their officers for this type of liability.

Under the Federal Sentencing Guidelines, both bribery and recordkeeping violations result in a baseline offense of two to eight months.[98] The term of imprisonment can then increase depending on the amount of money involved.[99]

Of course, the SEC additionally has the various enforcement tools available for its use when violations of the 1934 Act occur. Examples include the commencement of administrative enforcement actions, the right to conduct investigations[100] (results of which are sometimes used by the Department of Justice), and the power to subpoena witnesses and require the production of any books, papers,

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91. *See* 15 U.S.C. § 78dd-2(d) (1988).

92. *See* 15 U.S.C. §§ 78ff-2(c)(2)(B), 78dd-2(g)(2)(B) (1988). Under the 1988 amendments, the Eckhardt Amendment was repealed, allowing individual conviction regardless of corporate guilt.

93. *See* 15 U.S.C. § 78ff(a) (1988).

94. *See id.* Note that subsequent to the 1988 amendments the amount was changed to one hundred thousand dollars.

95. *See id.* Note that subsequent to the 1988 amendments this penalty was increased to ten years.

96. *See id.* Note that subsequent to the 1988 amendments this penalty was increased to 2.5 million dollars.

97 *See id.*

98. *See* U.S. SENTENCING COMM'N, UNITED STATES SENTENCING GUIDELINES MANUAL § 2B4.1(A) (1990).

99. *See id.* at § 2F1.1(b).

100. *See* 15 U.S.C. § 78u(a) (1988).

correspondence, memoranda, and records.[101] Thus, the statute grants extensive authority to the SEC to ensure corporate compliance with the FCPA.

Many of the enforcement actions for the FCPA recordkeeping violations involve corrupt payments to foreign officials as well. When the SEC determines improper payments have occurred, it usually seeks an injunction to obtain full compliance with the recordkeeping and internal control requirements of the Act.

The enhanced SEC authority granted under the FCPA poses an even greater concern to business when the potential statutory penalties, particularly criminal penalties, are considered.

## V. FURTHER EXPANSION OF SEC AUTHORITY THROUGH THE ISSUANCE OF RULES 13B2-1 AND 13B2-2, 1979

The SEC Report sent to Congress in 1976 on questionable and illegal corporate payments recommended the enactment of legislation that included the exact language of subsections 13(b)(2)(A) and (B) as ultimately adopted, plus two additional recommendations that Congress did not accept. When Congress did not adopt these recommendations as part of the FCPA, the SEC subsequently adopted the recommendations as SEC rules specifically related to the recordkeeping provisions of the FCPA.[102] These rules provide some additional guidance to corporations for identifying prohibited accounting procedures.[103]

Rule 13b2-1, promulgated under section 13(b)(2) of the Act provides that "[n]o person shall, directly or indirectly, falsify or cause to be falsified, any book, record, or account subject to section 13(b)(2)(A) of the Securities Exchange Act."[104] This rule clarifies that the SEC is primarily concerned with the deliberate falsification of books and records rather than with accidental errors. A second SEC rule, 13b2-2, states that:

> No director or officer of an issuer shall, directly or indirectly,
>
> (a) make or cause to be made a materially false or misleading statement, or
>
> (b) omit to state, or cause another person to omit to state, any material fact necessary in order to make statements made, in

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101. *See* 15 U.S.C. § 78u(b) (1988).

102. *See* 17 CFR §§ 240.13b2-1-2 (1988).

103. *See* S. Gregory Joy, *Application of Selected American Laws to United States Companies Transacting Business in Kuwait: Foreign Corrupt Practices Act and Antiboycott Legislation*, 43 MERCER L. REV. 691 (1992).

104. 17 CFR § 240.13b2-1 (1988).

> the light of the circumstances under which such statements were made, not misleading to an accountant in connection with (1) any audit or examination of the financial statements of the issuer required to be made pursuant to this subpart, or (2) the preparation or filing of any document or report required to be filed with the Commission pursuant to this subpart or otherwise.[105]

It is interesting that "these rules were not recirculated for comment despite the very real legal and policy issues they presented."[106] Also, one SEC Commissioner strongly objected in a dissenting opinion to the rules' adoption on the basis that they represented too broad an impact by the SEC on internal corporate governance. The majority of the SEC Commissioners, however, believed that the passage of the FCPA validated its "power and mandate to regulate internal corporate accounting practices."[107]

In one of the seminal court cases filed for violations of the accounting provisions of the FCPA and other SEC violations, *SEC v. World-Wide Coin Investments, Ltd.*, the Court interpreted the SEC rules.[108] The Court noted that they are a vital adjunct to the requirements codified in the statute, and additionally serve to "protect the integrity of the independent audit" function by the prohibition against making statements and material omissions to the independent auditor.[109]

These two rules are frequently invoked by the SEC when it files an enforcement action or complaint against a corporation for non-compliance with the FCPA. The adoption and application of these two rules represent the SEC utilizing the authority granted to it in the FCPA to regulate internal corporate affairs.

## VI. EMPHASIS ON ACCOUNTABILITY IN THE REPORT OF THE GENERAL ACCOUNTING OFFICE, 1981

The broad language and coverage of the accounting provisions immediately drew a negative response from SEC registrants subject to the Act. To determine the seriousness of the controversy, Congress asked the General Accounting Office to prepare a report on

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105. 17 CFR § 240.13b2-2 (1988).
106. KARMEL, *supra* note 21, at 156.
107. *Id.*
108. SEC v. World-Wide Coin Investments, Ltd., 567 F.Supp. 724 (N.D. Ga. 1983) [hereinafter World-Wide Coin].
109 *Id.* at 747.

the impact of the FCPA on U.S. businesses, which was submitted in 1981.[110]

The GAO Report includes in the reasons for enactment of the accounting provisions the significant statement that "the accounting provisions were intended largely as a *self-regulatory* measure (emphasis added)."[111] There is no mention whatsoever of an extension of SEC authority. The primary concern reflected in the GAO Report was lack of corporate accountability. The recordkeeping and internal control system sections of the FCPA were viewed as natural consequences of the revelations of prevalent corrupt practices by domestic and international corporations.[112]

Although there was liberal mention of the findings detailed in the 1976 SEC Report, no connection was made between the disclosure system which was the foundation of the 1934 Exchange Act, and the fact that the original FCPA gave broad authority to the SEC in the area of internal corporate affairs. Instead, the emphasis was placed on Congress having intentionally made the accounting provisions

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110. GAO REPORT, *supra* note 13. The GAO Report, which was based on a questionnaire survey of 250 companies (75% responded) randomly selected from the Fortune 1000 list of the largest U.S. industrial firms, set forth the following complaints expressed by the businesses surveyed:

- General vagueness of the accounting provisions.
- Lack of objective criteria for determining whether a recordkeeping or internal control deficiency is a violation
- Costly confusion over whether the provisions contain a materiality standard—a threshold for financial disclosure which limits management's reporting responsibilities to only material items.
- Perception that the accounting provisions have resulted in compliance costs greater than the benefits derived.
- Increased costs due to fear of criminal penalties for management judgments covering diverse and complex recordkeeping and internal control systems.

Companies have repeatedly complained that the broad language and subjectivity of the provisions impose unnecessary compliance burdens. Some noted a need to establish objective criteria for determining whether a recordkeeping or an internal control deficiency constitutes a violation. There were complaints that there is no consensus on the definition of "reasonable assurance." One firm commented that deciding whether a company's recordkeeping is accurate and reflects matters fairly or whether a system of internal accounting controls provides reasonable assurances involves complexities and uncertainties that make it difficult, if not impossible, to determine whether a company has complied with the Act.

Corporate management did not want to be held responsible for inadvertent or technical error. The Report states that the disagreement over whether a materiality standard is included in the Act exists between an American Bar Association (ABA) committee and the SEC. The ABA committee indicates that "the act does contain a materiality standard; the SEC says that a 'reasonableness' standard governs. Without a materiality standard, business perceives compliance as too costly. However, given the intent of the Act's accounting provisions to improve corporate accountability over assets, we believe the traditional standard of materiality related to financial disclosure is not appropriate." *See* GAO REPORT, *supra* note 13, at i-iii, 19-21, 23, 35, 82.

111. *Id.* at 69.

112 *Id.*

applicable to domestic corporations in a statute that by name seems to apply to corrupt acts in foreign countries.

The GAO Report makes the point that all who understand the analysis set forth in the 1976 Commission Report are aware that Congress had good reason to try to establish a system to ensure corporate accountability.[113] With that background, the writers of the GAO Report felt that it should be easy to comprehend Congress' motivation for the inclusion of both domestic and foreign SEC registrants. The next logical step that is not specifically addressed by the GAO is the necessity for the SEC to expand its scope of authority into internal corporate affairs to meet the statutory mandate for increased corporate accountability.

## VII. JUDICIAL INTERPRETATION OF THE FCPA: *SEC V. WORLD-WIDE COIN*

The accounting provisions of the 1977 Act were thoroughly evaluated and discussed by the judiciary for the first time in *SEC v. World-Wide Coin Investment, Ltd.*[114] The focus of SEC enforcement efforts between the 1977 adoption of the original Act and the 1983 *World-Wide Coin* case were related to the antibribery provisions. *World-Wide Coin* represented a significant shift in emphasis to SEC enforcement of accounting provision violations without an associated bribery violation; it is the first case based solely on the accounting provisions litigated completely through the trial phase. Both prior and subsequent to *World-Wide Coin,* most accounting provision cases have been settled by the SEC by consent decree or other means.

In the *World-Wide Coin* securities fraud case the defendant corporation, its majority owner and CEO, and its other officers were found by the United States District Court for the Northern District of Georgia to have violated section 13(b) of the FCPA. Additionally, defendant Hale, the Chairman and President of World-Wide Coin, was convicted of criminal securities violations involving section 13(b)(2) and rule 13b2-1 in a separate criminal action.[115]

The court's analysis began with a review of the history and purpose of the FCPA. Judge Vining's opinion noted that "the more significant addition of the FCPA is the accounting controls or 'books and records' provision, which gives the SEC authority over the entire

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113. *See id.* at 71.

114. World-Wide Coin, 567 F. Supp. at 724.

115. Hale received a jail sentence of five years and a $60,000 fine, followed by five years of probation. The court also granted a special condition requiring defendant to pay $175,000 in restitution to World-Wide Coin shareholders. *See id.* at 760.

financial management and reporting requirements of publicly held United States corporations."[116] The court also discussed the vital necessity of accurate recordkeeping as a mechanism to promote management accountability. The court stated that the recordkeeping requirements of the Act are "essential ingredients in promoting management responsibility and an affirmative requirement for publicly held American corporations to strengthen the accuracy of corporate books and records" in order to realize the legislative motivation of protecting the investor who implicitly relies on corporate representations that funds are accurately recorded and assets properly represented and maintained.[117]

According to Judge Vining, the FCPA has had tremendous impact on corporations, independent auditors, and the role of the SEC.[118] He specifically interpreted the accounting provisions of the statute to confer "new rule making and enforcement authority over the control and recordkeeping mechanisms of its registrants"[119] which expanded SEC authority beyond the traditional ambit of the disclosure system. This broadened SEC authority significantly increases federal control in the governance of corporate affairs.[120]

In the *World-Wide Coin* opinion, the court based its ruling on both Section 13(b)(2) of the FCPA and the SEC rules promulgated under the statute by the SEC.[121] The court indicated that the Act and its associated rules are rules of general application.[122] The opinion states that the statutes and rules were enacted to (1) assure that an issuer's books and records accurately and fairly reflect its transactions and the disposition of assets; (2) protect the integrity of the independent audit of issuer financial statements that are required under the Exchange Act; and (3) promote the reliability and completeness of financial information that issuers are required to file with the Commission, or disseminate to investors, pursuant to the Exchange Act.[123]

The *World-Wide Coin* opinion divided its analysis of the corporation's potential violations between the two relevant sections of the Act: Section 13(b)(2)(A), which governs the recordkeeping requirements and Section 13(b)(2)(B), which details the Act's internal control requirements.

116. *Id.* at 746.
117. *Id.*
118. *Id.*
119. *Id.*
120. *Id.*
121. *Id.*
122. *Id.*
123. *See* Goelzer, *supra* note 20.

### A. *Interpretation of the Recordkeeping Requirements*

In assessing the recordkeeping provisions of the original Act, *World-Wide Coin* enumerated three basic objectives of Section 13(b)(2)(A):

> (1) books and records should reflect transactions in conformity with accepted methods of reporting economic events, (2) misrepresentations, concealment, falsification, circumvention and other deliberate acts resulting in inaccurate financial books and records are unlawful and, (3) transactions should be properly reflected on books and records in such a manner as to permit the preparation of financial statements in conformity with GAAP."[124]

The Court supported congressional opinion that the term "accurately" in the original Act does not mean exact precision, but rather that financial recordkeeping should document transactions in conformity with Generally Accepted Accounting Principles (GAAP). The determination supports the position that neither Congress nor the SEC expects corporations to achieve exactitude when keeping their financial records.[125] However, the court interpreted the term "records" in the statute very broadly. This provided judicial support for the SEC to access virtually any tangible source of financial information.[126] As a result, the court substantially strengthened the SEC's authority to intrude extensively into the affairs of internal corporate management.

### B. *Interpretation of the Internal Control Requirements*

In *World-Wide Coin*, the court began its analysis of the internal control requirements by mentioning that the original Act contained no materiality standard, which allowed the SEC greater leeway in enforcing and prosecuting violations of the FCPA.[127] Instead, as the court found, "[t]he internal controls requirement is primarily designed to give statutory content to an aspect of management stewardship responsibility, that of providing shareholders with reasonable assurances that the business is adequately controlled."[128]

A key issue in *World-Wide Coin*, and in the business community then and now, is the extent to which a corporation must establish

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124. World-Wide Coin, 567 F. Supp. at 748.

125. *Id.* This position also lends support to a review of the relevant Generally Accepted Accounting Principles and Generally Accepted Auditing Standards that are used in achieving FCPA compliance.

126. *Id.* at 749.

127. *Id.*

128. *Id.*

internal controls in order to avoid potential FCPA liability. Defendant World-Wide Coin based part of its defense on a cost-benefit analysis. The court carefully evaluated the entire concept of internal control. The SEC was quoted as stating: "The internal accounting controls element of a company's control system is that which is specifically designed to provide reasonable, cost-effective safeguards against the unauthorized use or disposition of company assets, and reasonable assurances that financial records and accounts are sufficiently reliable for purposes of external reporting."[129] Once again, the Court supported SEC authority over internal corporate structures on the need for these structures to provide reliable financial information to external entities. Also, the Court acknowledged that the definition of internal control anticipates reasonable, but not absolute, assurances.

The Court applied its legal conclusions to the facts of *World-Wide Coin*. The Court's greatest concern was that World-Wide Coin had been advised by its independent auditors that there were serious weaknesses in its internal controls that constituted potential FCPA violations. The independent auditors, and later the Court, commented on weaknesses such as: no adequate segregation of duties, no documentation to support transactions, and accounting records that were inadequate and not properly filed. Although notified of these deficiencies and possible FCPA violations by the auditor's opinion letter, World-Wide Coin management took no corrective action. Consequently, the Court found World-Wide Coin in violation of Section 13(b)(2) of the FCPA and ordered a full fraud accounting and disgorgement of wrongfully received benefits by defendant Hale.[130] The intense scrutiny by the Court in *World-Wide Coin* illustrates the most far-reaching impact of the FCPA: the dramatic increase in the SEC's authority to intervene in internal corporate governance. The Court's analysis in *World-Wide Coin* of the legislative history and Congressional intent behind the FCPA further supports this enhanced SEC authority.

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129. *Id* at 750. A reasonableness concept implicitly recognizes that the costs of internal control should not exceed benefits. In *World-Wide Coin,* Justice Vining reviewed legislative history and SEC recommendations, and concluded that a fail-safe internal control system was never intended, and that cost-effective considerations were an inherent component of "reasonableness." However, he held that an issuer or covered corporation would probably not be successful in arguing a cost-benefit analysis where management has been given notice or warned by its auditors of a significant weakness in its accounting internal controls. *Id.* at 751-52, 760. *See also* 134 CONG. REC. S8527-06 (daily ed. June 24, 1988) (statement of Senator William Proxmire).

130. *World-Wide Coin,* 567 F. Supp. at 751-52, 760.

## VIII. PASSAGE OF THE AMENDMENTS TO THE FCPA IN THE OMNIBUS TRADE AND COMPETITIVENESS ACT, 1988

As a result of *World-Wide Coin*, the GAO report, and the continually expressed dissatisfaction of the business community, Congress included an amendment to the FCPA in the Omnibus Trade and Competitiveness Act.[131] All attempts to amend the FCPA prior to 1988 had failed. Senator William Proxmire (D-Wisc.), a primary author of the original FCPA, argued that the controversial and complex Trade Act provided a vehicle for anti-FCPA members of Congress to pass amendments to the Act that could not have passed on their own. Proxmire claimed that these anti-FCPA Congress members made a deliberate attempt to "bury the few fatal lines that killed the Foreign Corrupt Practices Act deep in the forest of hundreds of thousands of words."[132]

### *A. Deletion of the "Reason To Know" Standard*

The original 1977 Act included a provision that imposed criminal penalties on individuals and corporations for failure to comply with the accounting provisions where they knew or had reason to know of such failure.[133] In the 1988 amendments the "reason to know" language was deleted.[134] The amended provision provides there will be no liability for violation of the accounting provisions unless a corporation "shall knowingly circumvent or knowingly fail to implement a system of internal accounting controls or knowingly falsify any book, record, or account."[135] The Conference Report states that this provision was intended "to ensure that criminal penalties would be imposed where acts of commission or omission in keeping books, records or administering accounting controls" have occurred.[136]

Deletion of the "reason to know" standard simply codified SEC enforcement policy that had been implemented under the provisions of the 1977 Act.[137] The SEC recognized that the reason to know standard potentially imposed an unnecessarily broad basis for

131. *See* Trade Act, *supra* note 14.
132. 134 CONG. REC. S8527-06 (daily ed. June 24, 1988).
133. *See* Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, tit. I, 91 Stat. 1494(1).
134. *See* 15 U.S.C. § 78m(b)(5) (1988).
135. *Id.*
136. H.R. CONF. REP. 916-925 (1988) *reprinted in* 134 CONG. REC. H1863 (daily ed., Apr. 20, 1988) [hereinafter CONFERENCE REPORT]. This Conference Report was adopted by the conferees as the legislative history of the Amendments.
137. Foreign Corrupt Practices Act of 1977, Exchange Act Release No. 17,500, 21 S.E.C. Docket 1466 (Jan. 29, 1981) [hereinafter ENFORCEMENT POLICY].

liability. The SEC published a release in 1981 that set forth its enforcement policy.[138] The release included a statement that the SEC's objective was "to encourage a private-sector compliance with the spirit of the Act and not impose standards of exactitude for corporate records" and that company "records only need be kept in reasonable detail."[139] This gave companies some leeway in meeting full compliance.

To give greater assurance to the business community that the SEC would only pursue serious misconduct, the enforcement policy statement of release provided that "inadvertent recordkeeping mistakes and falsifications of which management was not aware and reasonably should not have known will not result in SEC enforcement proceedings."[140] The SEC tried to resolve any ambiguities by delineating conduct that would initiate SEC enforcement proceedings: "Failure to correct a known falsification (or one that reasonably should have been known), any attempt to cover-up falsification, or the creation or maintenance of any fund designed to be used for 'off books' payments."[141]

Eliminating the "reason to know" in the 1988 amendments to the FCPA greatly reduced the ambiguities that caused such extensive corporate concern with compliance. It is significant to note, however, that because the SEC enforced only "knowing" violations anyway, this change did not restrict the SEC's authority to regulate internal corporate affairs, including recordkeeping and internal accounting controls.

### B. *"Good Faith Effort" Requirements for U.S. Companies with a Minority Interest in a Foreign Subsidiary*

A vital addition to the FCPA is the 1988 amendment that clarifies a corporation's responsibility for the financial recordkeeping and internal accounting controls of its subsidiaries.[142] The amendment applies to all issuers of SEC registered securities with respect to the accounting practices of either a foreign or domestic subsidiary.[143] This provision distinguishes corporate FCPA responsibility of a parent company for its subsidiaries based on the percentage of ownership in the subsidiary.[144] If a corporation holds 50 percent or

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138. *See id.*
139. *Id.*
140. *Id.*
141. *Id.*
142. 15 U.S.C. § 78m(b)(6) (1988).
143. *Id.*
144. *See id.*

less of the voting power in a foreign or domestic firm, the corporation is required only to "proceed in good faith to use its influence, to the extent reasonable, under the issuer's circumstances" to make the subsidiary comply with the recordkeeping and internal control requirements of the FCPA.[145] A corporation covered by the statute that owns more than 50 percent of a subsidiary must require that subsidiary to comply fully with the original 1977 financial reporting and internal control provisions. The amendment proceeds to clarify further circumstances that would be relevant in determining whether "good faith" efforts were reasonable.[146] The percentage of ownership and the laws and practices governing the business operations of the country in which the subsidiary is located are specifically mentioned.[147] Although it narrows the pool of companies subject to SEC enforcement, this amendment has little impact on SEC authority because the SEC had been willing to consider that a minority U.S. owner could only exert influence to achieve FCPA compliance. A minority owner clearly does not have sufficient vote to dictate a course of action to its foreign subsidiary.

### *C. Clarification of the "Reasonable Detail" and "Reasonable Assurance" Standards on Recordkeeping and Internal Control*

Since the inception of the 1977 Foreign Corrupt Practices Act, the business community has argued that compliance with the Act's accounting provisions is costly and confusing because the amount of disclosure required by the Act is unclear.[148] Too much compliance effort in financial recordkeeping and internal controls could be quite expensive, and yet, insufficient compliance could leave a corporation vulnerable to an enforcement action by the SEC. The 1988 amendment attempted to clarify the meaning of the original Act's requirements that (1) companies keep financial records in reasonable detail, and (2) maintain internal controls to provide reasonable assurances as to accountability for assets.

Congress attempted to clarify the meaning of the terms "reasonable detail" and "reasonable assurances" through the adoption of the "prudent person" standard in the 1988 amendments.[149] The terms "reasonable detail" and "reasonable assurances" were further de-

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145. *Id.*

146. *See id.*

147. *See id.*

148. *See* GAO REPORT, *supra* note 13 at i, 19, 21, 82.

149. SENATE COMM. ON BANKING, HOUSING, AND URBAN AFFAIRS, FOREIGN CORRUPT PRACTICES AND DOMESTIC AND FOREIGN INVESTMENT IMPROVED DISCLOSURE ACTS OF 1977, S. REP. NO. 114, 95th Cong., 1st Sess, 7 (1977) [hereinafter S. REP. NO. 114].

fined to require such level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs.[150] An immediate question that arises is whether the "prudent official" language really does clarify the extent of corporate action required for FCPA compliance. The result of the amendments as adopted may well leave the issue of the extent of required disclosure ambiguous. A number of questions arise. How is "prudent" defined? If a prudent official does not rely solely on a cost/benefit analysis, then on what factors does he/she rely? Conceivably, a prudent official may actually require a more exacting awareness than a reasonable person would.

The prudent person concept is one that recurs frequently in the law. The standard is used to articulate what a reasonable person would do under similar circumstances, while accepting that there should be a legal limit to responsibility for human conduct.[151] The prudent person test as defined in both general tort law and as part of breach of fiduciary duty claims may provide guidance to courts interpreting FCPA accounting provisions.

In general tort law, the prudent person exercises the same level of "foresight, caution, judgment, self-control, and the like" as that found in the general community.[152] The reasonably prudent person is not infallible or perfect.[153] The prudent person needs to be aware, however, that the general practice of the community may not reflect what is careful.[154] Thus, the standard has been interpreted to mean what ought to be generally done, rather than what is generally done.[155]

The Committee of Sponsoring Organizations of the Treadway Commission transformed this general standard into more specific guidelines for the accounting, auditing and financial communities responsible for internal accounting controls.[156] The Committee was formed upon the recommendation of the 1987 National Commission on Fraudulent Financial Reporting. The Committee's report provides suggestions to covered corporations and their auditors concerning the attributes of the prudent person that are pertinent to internal control. In the Report the Committee discusses the following "prudent person" characteristics:

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150. *Id.*

151. Internal Control-Integrated Framework Exposure Draft, Mar. 12, 1991, Comm. of Sponsoring Orgs. of the Treadway Comm'n [hereinafter EXPOSURE DRAFT].

152. F. HARPER, ET AL., THE LAW OF TORTS, VOL. 3, 389-90 (2d ed., 1956).

153. *See id.*

154. *See id.*

155. *See id.*

156. *See* EXPOSURE DRAFT, *supra* note 151.

- A prudent person should exercise judgment equal to that of the level in his community.
- A prudent person uses the knowledge that he or she possesses with reasonable intelligence. He/she is considered to have the average ability to perceive risks and their consequences.
- A prudent person should possess and exercise reasonable skill in his/her occupational activities. Reasonable skill is that possessed by the general class of people engaged in that activity or line of work.[157]

Thus, courts are now equipped with guidelines to interpret "prudent" when determining whether a company has satisfied the requirements of the FCPA. However, there has not yet been a detailed judicial analysis of the meaning of "prudent" in the context of the FCPA. Therefore, at this time a corporation attempting to comply with the FCPA accounting provisions and avoid SEC intervention should rely on the guidelines from the accounting community, such as the Treadway Commission guidelines discussed above.

## IX. REVIEW OF CASES SUBSEQUENT TO THE 1988 AMENDMENTS REINFORCING SEC AUTHORITY

Between the enactment of the FCPA in 1977 and its amendment in 1988, only twenty-three cases were brought by the SEC and the Department of Justice combined.[158] The number of cases brought by the SEC since the 1988 amendments has also been small. However, a number of more recent events and factors indicate an increase in the enforcement of the FCPA.[159] Such factors include renewed global interest in anticorruption efforts for international business since the cessation of the Cold War, and policy changes within the U.S. government.[160] The current SEC Associate Director of Enforcement has indicated that the SEC will be bringing more cases for FCPA noncompliance in the future.[161] Both the SEC and the Department of Justice have begun to enforce the FCPA provisions more aggressively in the last few years. Cases that involve accounting provision violations are discussed below.

157. *See id.*

158. *See* Steven Salbu, *Bribery in the Global Market: A Critical Analysis of the Foreign Corrupt Practices Act*, 54 WASH. & LEE L. REV. 229, 242 (1997).

159. *See* Carolyn Hotchkiss, *The Sleeping Dog Stirs: New Signs of Life in Efforts to End Corruption in International Business* (1997).

160. *Id.*

161. *See* Bencivenga, *supra* note 4.

### A. SEC v. Nelsen & Tallant

In *SEC v. Nelsen and Tallant*,[162] the District Court of the District of Columbia approved a settlement between the parties in which Nelsen and Tallant agreed to a permanent injunction against violating certain securities laws and provisions, including SEC Rules 13b2-1 and 13b2-2, and against serving as officers and director of a public company.[163]

### B. In re *Gore*,[164] SEC v. Triton Energy Corp.

*SEC v. Triton Energy Corp.*[165] concerned a number of alleged violations of both the FCPA bribery and accounting provisions by Triton Energy Corporation in Indonesia and its officers and employees.[166] In each instance that an improper payment was made to secure concessions from various government agencies in Indonesia, false documentation was prepared to shield the nature of the payment.[167] The SEC found defendants Triton and Murphy violated Section 13(b)(2)(A) by creating and recording false entries in Triton's books.[168] Interestingly, senior managers Gore and Puetz were also found in violation of the same section of the FCPA for having known that Triton was engaged in potentially unlawful conduct, yet failing to investigate or halt such conduct.[169] This knowledge was evidenced by an internal auditor's memorandum advising management of the illegal payment.[170] As previously noted, courts will find corporations and their top management to have violated the FCPA whenever senior management has been advised of potential violations by internal or external auditors' memos, and has not acted to investigate and stop the potential violations. Thus, *SEC v. Triton Energy Corp.* represents another example of the SEC's expanded authority to delve into internal corporate management to prosecute FCPA violations.

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162. SEC v. Nelsen & Tallant, C.A. No. 1:97CV00798 (D.D.C. 1997); Exchange Act Release No. 15,343.
163. *Id.*
164. *In re* Gore, Adm. Proceeding File No. 3-9262 (1997); Exchange Act Release No. 38,343.
165. SEC v. Triton Energy Corp., C.A. No. 1:97CV00401 (D.D.C. 1997).
166. *See Gore*, C.A. No. 1:97CV000401.
167. *Id.*
168. *Id.*
169. *Id.*
170. *Id.*

### C. SEC v. Montedison

Another example of the SEC's expanded power is *SEC v. Montedison*,[171] in which the SEC alleged that Montedison, an Italian corporation, had been paying bribes to Italian government officials and had violated the FCPA's accounting provisions by "engaging in a fraudulent scheme to materially misstate its financial condition and results of operations on its books and records."[172] This case presents an interesting jurisdictional issue because the SEC is asserting jurisdiction over a foreign company that paid bribes in its own country on the basis that Montedison sells American Depository Receipts on the New York Stock Exchange.[173] *Montedison* is still pending, as is the issue of the SEC's jurisdictional reach.

### D. In re Nolder

*In re Nolder*,[174] the controller and chief accounting officer of Chambers Development Company, was found to have violated Rule 13b2-1 of the Exchange Act.[175] Nolder failed to properly document a method for measuring capitalizable costs according to GAAP and failed to document material costs that were capitalized. Additionally, Nolder failed to take sufficient and timely steps to help Chambers develop an adequate internal control system. The SEC accepted Nolder's offer to settle, in which he agreed to cease and desist from any future violations of the Exchange Act and Rule 13b2-1.[176] *In re Nolder* is another example of the SEC intruding into very specific functions of corporate management. Interestingly, it is also a case in which no allegations of bribery or other improper payments in this matter were made.

### E. In re Jensen

*In re Jensen*,[177] is an example of an auditor being disciplined by the SEC for failing to note the material internal control weaknesses while engaged in auditing the financial records of his client, TVCN.

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171. SEC v. Montedison, C.A. No. 1:96CV02631 (D.D.C. 1996); Exchange Act Release No. 15,164.

172. *Id.*

173. *Id.*

174. *In re* Nolder, Adm. Proceeding No. 3-8691 (1995); Exchange Act Release No. 35,692.

175. *Id.*

176. *Id.*

177. *In re* Jensen, Adm. Proceeding No. 3-8307 (1994); Exchange Act Release No. 33,696.

### F. United States v. O'Hara

In *O'Hara*[178] the defendant pleaded guilty to criminal violations of the FCPA. O'Hara aided and abetted co-conspirators, Harris Corporation and its officers, in bribing Columbian officials to obtain telecommunications business and then falsely recording the payments on the books as incidental fees to O'Hara.[179] Although the defendant had been fully informed about his guilty plea by the judge, he later attempted to withdraw the plea on the basis that a directed verdict relating to his co-conspirators in a separate proceeding led to their acquittal.

The Second Circuit ruled that the acquittal of the co-conspirators had no preclusive effect in this case; O'Hara's guilty plea remained legally valid.[180]

### G. Shields v. Erickson

*Shields v. Erickson*[181] raised the fascinating legal issue as to whether a private right of action exists under Section 13(b)(2) of the FCPA. Plaintiff shareholders of Sundstrand Corporation brought a civil shareholder derivative action against the officers and directors for permitting and acquiescing in the wrongful acts which resulted in criminal convictions, and for allowing Sundstrand Corporation to maintain an inadequate system of internal controls. The shareholders alleged Sundstrand's assets could be misused[182] and thus injure the value of their stock in the corporation. Defendant responded by arguing that Section 13(b)(2) does not provide a private right of action.

The court, in the *Shields* opinion, noted that no Court of Appeals had yet decided this issue.[183] Additionally, the court reviewed a California District Court opinion in *Lewis v. Sprock*[184] that had decided this issue. In *Lewis*, the court found upon a review of the legislative history that Congress did not intend to create a private right of action under the FCPA.[185] The court in *Shields* found the California court's reasoning persuasive, and also found no private right of action.[186] This case, while limiting the rights of private parties

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178. United States v. O'Hara, 960 F.2d 11 (2d Cir. 1992).
179. *Id.*
180. *Id.*
181. Shields v. Erickson, 710 F. Supp. 686 (N.D. Ill. 1989).
182. *Id.*
183. *Id.*
184. Lewis v. Sprock, 612 F. Supp. 1316, 1332 (N.D. Cal. 1985).
185. *Id.*
186. *See* Shields, 710 F. Supp. at 688.

purportedly injured by FCPA violations, has no effect on SEC enforcement authority over violators of the FCPA.

## X. SEC AUTHORITY STRENGTHENED THROUGH IMPLEMENTATION OF THE FCPA THROUGH USE OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, GENERALLY ACCEPTED AUDITING STANDARDS, AND ESTABLISHED PRACTICES

At the time that Congress initially adopted the FCPA, it did so knowing that the accounting profession had a body of generally accepted accounting principles, generally accepted auditing standards and established practices already in place.[187] A review of the SEC and accounting literature directed toward facilitating FCPA compliance through integration of GAAP, Generally Accepted Auditing Standards (GAAS), and SEC Rules and Policy is one indication of how courts may interpret the requirement of "reasonable detail" and "reasonable assurance" requirements for recordkeeping and internal control systems. The SEC utilizes its increased enforcement power through the mechanisms of GAAP and GAAS to measure compliance with the FCPA accounting provisions.

One goal of the relevant accounting literature and the FCPA is that transactions are accurately and fairly recorded as necessary to permit preparation of financial statements in conformity with GAAP.[188] Additionally, the FCPA requires that transactions correctly reflect the disposition of assets and flow of corporate funds.[189] Subsection A of section 13(b)(2) of the FCPA states that corporations must make and keep financial records accurately reflecting the company's transactions in reasonable detail. Doing so is intended to prevent the very corporate practices that influenced Congress to adopt the FCPA, such as unrecorded funds, double recordkeeping, and payment of bribes. Subsection A ensures the accuracy of corporate books, and strengthens the integrity of the audit process.

### A. *Errors and Irregularities in Financial Recordkeeping*

The body of accounting rules identify two primary difficulties encountered by auditors when they are reviewing the financial recordkeeping of a corporation for accuracy. The two common

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187 *See* S. REP. 144, *supra* note 149.

188. *See* American Institute of Certified Public Accountants, Statement on Auditing Standards No. 1, *Codification of Auditing Standards and Procedures* (1972) [hereinafter SAS No. 1].

189. *See* 15 U.S.C. § 78m(b)(2)(A) (1988).

problems are errors and irregularities.[190] Errors reflect unintentional misstatements or omissions of amounts or disclosures in financial statements.[191] Examples would include mathematical or clerical mistakes in the gathering or processing of underlying records, and mistakes in the application of accounting principles relating to amount, classification, and so forth.[192] Conceivably, it is not possible to prepare an all-inclusive list of potential errors, nor is it possible to develop affordable, preventive controls for all errors.[193]

One factor that an auditor would consider when evaluating an error is whether the error is material in amount.[194] A material error in the financial records that is used to prepare the corporate financial statements is a violation of Subsection A of the accounting provisions.[195] A pattern of material or minor errors in a corporation's record keeping may lead to a Subsection A violation if the SEC and the court determines the corporation was reckless in preparing financial statements that did not properly record transactions or reflect assets.[196]

Irregularities are defined in the accounting literature as intentional misstatements or omissions of amounts or disclosures in financial statements.[197] Irregularities include fraudulent financial reporting undertaken to render financial statements misleading, and misappropriation of assets, called defalcations.[198] Deliberate falsifications and distortions of financial statements are violations of Subsection A's compliance requirements. Additionally, if the independent auditor of the corporation discovers an irregularity and notifies the corporate management, then management must immediately rectify the irregularity and adopt internal controls to prevent that type of irregularity in the future to avoid potential liability for an FCPA violation.[199]

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190. *See* American Institute of Certified Public Accountants, Statement on Auditing Standards No. 53, *The Auditor's Responsibility to Detect and Report Errors and Irregularities* (1988) at 1 [hereinafter SAS No. 53].

191. *See id.*

192. *See id.*

193. *See id.*

194. *See id.* at 15.

195. *See* Barbara Crutchfield George & Mary Jane Dundas, *Responsibilities of Domestic Corporate Management under the Foreign Corrupt Practices Act*, 31 SYRACUSE L. REV. 865 (1980).

196. *See id.*

197. *See* SAS No. 53, *supra* note 190.

198. *See id.*

199. *See* 15 U.S.C. § 78m(b)(2)(A) (1988).

### B. Internal Control

Subsection B of the FCPA requires that each corporation subject to SEC jurisdiction shall devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that:

> (i) transactions are executed in accordance with management's general or specific authorization;
> (ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other applicable criteria, and (II) to maintain accountability for assets;
> (iii) access to assets is permitted only in accordance with management's general or specific authorization; and
> (iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals, and appropriate action is taken with respect to any differences.[200]

This requirement dovetails with the AICPA (American Institute of Certified Public Accountants) internal control requirements[201] and the recommendations of the Treadway Commission regarding internal controls.[202]

One specific issue raised by the corporations regarding FCPA compliance is that the meaning of "reasonable assurances," like "reasonable detail" in Subsection A, is unclear.[203] Each additional internal control devised by a company has both associated benefits and costs. The 1981 SEC Enforcement Policy for the FCPA (the Policy) provided two guidelines to assist corporations with this issue.[204]

First, the Policy states that the term reasonableness means an inherent toleration of deviations. The test is whether a system taken as a whole reasonably meets the statute's objectives.[205] Second, the Policy indicated that a "cost/benefit analysis is one measure of reasonableness; companies are not expected to install costly systems not justified by their benefits."[206] Further, the Policy statement notes that "considerable deference will be given to the company's reasonable business decisions."[207] The Commission is utilizing the business judgment rule frequently invoked in courts, by stating that it will not

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200. 15 U.S.C. §78m(b)(2)(B) (1988).
201. *See* SAS No. 1, *supra* note 188.
202. *See* EXPOSURE DRAFT, *supra* note 151.
203. *See* GAO REPORT, *supra* note 13.
204. *See* ENFORCEMENT POLICY, *supra* note 137.
205. *See id.*
206. *Id.*
207. *Id.*

substitute its judgment for that of management.[208] Finally, an adequate system of internal control will not and cannot prevent occasional failures. It can, however, assure prompt detection of the failure and rectification of it.

In summary, the accounting standards and generally accepted accounting principles provide the specific mechanisms that the SEC utilizes to implement the FCPA. The SEC reviews internal corporate decisions and strategies relative to the financial recordkeeping and reporting, rather than merely requiring the disclosure of financial information as it had done prior to the passage of the FCPA. This dramatically increases SEC authority to both review and potentially dictate internal corporate financial decisions.

## XI. CONCLUSION

The accounting provisions of the FCPA were considered by some to be the broadest application of federal law to corporate management and accountability since the 1934 Act.[209] In that Act Congress' main objective was to prohibit misrepresentation and other wrongful conduct by requiring every securities issuer to file periodic reports disclosing financial information to facilitate informed decisions by investors.[210] The prevailing principle underlying both the 1933 and 1934 Securities Acts was the emphasis on establishing an open, fair, and orderly securities market for investors.[211]

In the decade prior to the adoption of the FCPA, there was dissatisfaction with the effectiveness of the disclosure system in providing a fair market. There were a number of parallel occurrences concerning corporate misconduct: the consumer movement, the proposed federal incorporation statute, the proposed minimum standards for state corporate laws, and the Watergate scandal. As a result, Congress became convinced it was necessary to ensure corporate accountability and an orderly securities market through the passage of statutory requirements for accurate financial recordkeeping and establishment of internal control systems.

The FCPA provided the SEC with the opportunity to directly intervene in corporate governance by dictating how businesses should keep financial records, record transactions, and implement

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208. *See* William Bottiglieri, et al., *The Foreign Corrupt Practices Act: Disclosure Requirements and Management Integrity*, SAM ADVANCED MGMT. J. (1991).

209. *See* KARMEL, *supra* note 21.

210. *See* SECURITIES AND EXCHANGE COMMISSION, A 25 YEAR SUMMARY OF THE SEC at XXII (1961).

211. *See id.* at XXI.

systems of internal control.[212] In 1979, the SEC further established its position of authority over corporate governance by its promulgation of two rules which prohibited making false or misleading statements to outside auditors and prohibited the falsification of any book, record, account, or document for any accounting purpose.[213]

The SEC authority under the FCPA has withstood all challenges. In one of the only cases interpreting the extent of SEC authority under the FCPA, the 1983 *World-Wide Coin* case, the judge reaffirmed that the accounting provisions of the Act are "essential ingredients in promoting management responsibility" and necessary to protect the investor.[214] Through 1997 there have been no cases providing judicial support for curtailing the regulatory powers of the SEC granted to it in the FCPA. Despite the pressures from business and the recommendations of the GAO Report,[215] the amendments finally passed in 1988 did not significantly restrict the scope of SEC authority.

While the amendments deleted the "reason to know" standard as a basis of liability, it was actually a codification of a prior SEC Enforcement Policy and SEC authority over corporate internal affairs remained intact. Another provision within the amendments sought to clarify the "reasonable detail" and "reasonable assurance" standards by establishing a "prudent official" standard. The issue of the extent of required disclosure remains ambiguous and still allows the SEC to wield the increased authority granted to it in the original Act. The only discernible curtailment of authority was in the amendment distinguishing between the responsibilities of majority and minority interests in foreign subsidiaries.

The specter of the potential for SEC intrusion over internal corporate governance remains a serious concern for the business community twenty years after the initial statutory mandate. The history of insider trading regulation may provide an example of how the powers of the SEC may lie dormant for decades only to be wielded aggressively at a later time. Although the SEC issued Rule 10b-5 in 1942, a vigorous enforcement program utilizing the rule in insider trading cases did not occur until the *Cady Roberts*[216] case in 1961.

The business community will be well advised to remain alert for the potential threat of the SEC's enhanced authority under the FCPA

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212. *See* 15 U.S.C. § 78m(b)(2) (1988).
213. 17 CFR § 240.13b2-1 (1988), 17 CFR § 240.13b2-2 (1988).
214. *See World-Wide Coin*, 567 F. Supp. at 752.
215. *See* GAO REPORT, *supra* note 13.
216. *See Cady Roberts*, *supra* note 29 at 907.

being used in the same aggressive manner at some indeterminate future time. The current increase in SEC enforcement of both the antibribery and accounting provisions of the Act, as evidenced by the recent cases filed and the statement of the present Associate Director,[217] provides an indication that the SEC will more actively use its authority in the area of internal corporate governance.

217. *See* Bencivenga, *supra* note 4.