Journal of Criminal Law and Criminology

Volume 96
Issue 2 *Winter*

Article 4

Winter 2006

The Potent and Broad-Ranging Implications of the Accounting and Record-Keeping Provisions of the Foreign Corrupt Practices Act

Stuart H. Deming

0091-4169/06/9602-0465
THE JOURNAL OF CRIMINAL LAW & CRIMINOLOGY
Copyright © 2006 by Northwestern University School of Law
Vol. 96, No. 2
Printed in U.S.A.

THE POTENT AND BROAD-RANGING IMPLICATIONS OF THE ACCOUNTING AND RECORD-KEEPING PROVISIONS OF THE FOREIGN CORRUPT PRACTICES ACT

STUART H. DEMING*

The criminal law of every country makes the corruption of its public officials a criminal offense.[1] Yet, until the latter part of the 20th century, almost every country limited the prohibitions to its own officials and not officials of other countries or international organizations.[2] This was in spite

* Stuart H. Deming practices with DEMING PLLC in its offices in Washington, D.C. and Kalamazoo, Michigan. He previously served with the Securities and Exchange Commission ("SEC") and in various capacities with the U.S. Department of Justice. Mr. Deming is the author of *The Foreign Corrupt Practices Act and the New International Norms* recently published by the American Bar Association ("ABA") and a member of the board of editorial advisors to Business Laws, Inc. (FCPA). For many years, he co-chaired the ABA's National Institutes on the Foreign Corrupt Practices Act and was a founder and a co-chair of the ABA's Task Force on International Standards for Corrupt Practices. Mr. Deming received his B.A., M.B.A., and J.D. from the University of Michigan. He has also been licensed as a Certified Public Accountant in the State of Michigan.

[1] *See* Jefferi Joan Hamilton, Note, *Foreign Corrupt Practices Act of 1977: A Solution or a Problem?*, 11 CAL. W. INT'L L.J. 111, 134 (1981).

[2] That situation has dramatically changed in recent years with the adoption and implementation of a series of international anti-bribery conventions by much of the developed world and increasingly by much of the developing world. Following the adoption of the Foreign Corrupt Practices Act in 1977, the United States was for many years the only country to prohibit improper payments to foreign officials. The adoption in 1997 by the Organization of Economic Co-operation and Development of the Convention on Combating Bribery of Foreign Officials in International Business Transactions ("OECD Anti-Bribery Convention") led to the implementation by most of the developed world of prohibitions on improper payments to foreign officials. Nov. 21, 1997, OECD DOC. DAFFE/IME/BR(97)20, *reprinted in* Argentina-Brazil-Bulgaria-Chile-Slovak Republic-Organization for Economic Cooperation and Development: Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, Dec. 18, 1997, 37 I.L.M. 1. Much of the rest of the world either has or is in the process of implementing similar prohibitions through the implementation of the Organization of American States' Inter-American Convention Against Corruption, Mar. 29, 1996, OAS DOC. B-58, *reprinted in* Organization of American States: Inter-American Convention Against Corruption, Mar. 29, 1996, 35 I.L.M. 724, which was adopted in 1996. *See also* Council of Europe Criminal

of general, if often unstated, agreement that the proliferation of this form of corruption threatens the functioning of democratic institutions and market economies.[3]

In 1977, as an outgrowth of the Watergate scandal and a series of revelations associated with that period,[4] Congress adopted the Foreign Corrupt Practices Act ("FCPA") to deter improper payments to foreign officials.[5] Yet, in reality, the FCPA's provisions play a far greater role in legal jurisprudence in the United States and elsewhere than is generally recognized. Aside from directly affecting business practices of individuals and entities in international settings, on a daily basis the FCPA bears directly on the foreign and domestic operations of publicly-held companies and many foreign companies entering U.S. capital markets. Often, in unexpected ways, it is increasingly having an impact on litigation and arbitral proceedings.[6]

Law Convention on Corruption ("CoE Criminal Law Convention"), ETS No. 173 27.1.1999, which was adopted in 1998; and the United Nations Convention Against Corruption ("UN Convention"), G.A. Res. 58/4, U.N. GAOR, 58th Sess., U.N. DOC. A/RES/58/4 (2003), *reprinted in* United Nations Convention Against Corruption, Dec. 11, 2003, 43 I.L.M. 37 (2004), which was adopted in 2003. All of these anti-bribery conventions have now entered into force.

[3] STUART H. DEMING, THE FOREIGN CORRUPT PRACTICES ACT AND THE NEW INTERNATIONAL NORMS 1 (2005).

[4] "Beginning in 1973, as a result of the work of the Office of the Watergate Special Prosecutor, the [Securities and Exchange] Commission became aware of a pattern of conduct involving the use of corporate funds for illegal domestic political contributions." Promotion of Reliability of Financial Information, Exchange Act Release No. 34-15570, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,959, at 81,960 (Feb. 15, 1979) [hereinafter Exchange Act].

> Subsequent Commission investigations revealed that instances of undisclosed questionable or illegal corporate payments—both domestic and foreign—were indeed widespread and represented a serious breach in both the operation of the Commission's system of corporate disclosure and, correspondingly, in public confidence in the integrity of the system of capital formation.

Id. More than 400 corporations admitted making questionable payments. H.R. REP. NO. 95-640, at 4 (1977), *reprinted in* 2 BUSINESS LAWS, INC. (FCPA) 342. "The abuses disclosed run the gamut from bribery of high foreign officials . . . to secure some type of favorable action by a foreign government to so-called facilitating payments . . . to ensure that government functionaries discharged certain ministrial [sic] or clerical duties." *Id.*

[5] 15 U.S.C. §§ 78m, 78dd-1, 78dd-2, 78dd-3, 78ff (2000 & Supp. 2005).

[6] The FCPA can serve, for example, as a basis in certain situations for not enforcing a contract. In litigation in U.S. courts and in other common law jurisdictions, the "unclean hands" doctrine can bar a claim for equitable relief. DEMING, *supra* note 3, at 381. In some situations, the doctrine has also been applied to bar a cause of action where a payment may have been made in violation of the anti-bribery provisions. 15 U.S.C. §§ 78dd-1, 78dd-2, 78dd-3; *see, e.g.*, Adler v. Federal Republic of Nig., 219 F.3d 869, 876-78 (9th Cir. 2000); SEDCO Int'l, S.A. v. Cory, 683 F.2d 1201, 1210-11 (8th Cir. 1982).

I. THE FCPA'S TWO PRINCIPAL MECHANISMS

Initially designed to deter improper payments to foreign officials in connection with business activities, the FCPA instituted two basic mechanisms to carry out its purposes. One is a set of prohibitions on payments to foreign officials.[7] These are generally referred to as the "anti-bribery provisions." The anti-bribery provisions first come to mind when reference is made to the FCPA. They prohibit any promise, offer, or payment of anything of value if the offeror "knows" that any portion will be offered, given, or promised to a foreign official, foreign political party, or candidate for public office for the purpose of influencing a governmental decision.[8]

The second mechanism is comprised of a set of provisions known as the "accounting and record-keeping provisions."[9] Through the accounting and record-keeping provisions, the FCPA placed new and significant affirmative obligations on entities subject to its terms to maintain systems of internal controls and to maintain records that accurately reflect transactions and dispositions of assets.[10] These provisions directly affect business practices unrelated to the making of improper payments to foreign officials. In so doing, they directly affect the worldwide operations of entities subject to their terms and extend to their majority-owned subsidiaries and officers, directors, employees, shareholders, and agents acting on their behalf.[11]

In the context of international arbitration, arbitral tribunals and courts enforcing or annulling arbitral awards are increasingly confronted with situations where the enforcement of a contract or of an award relating to a contract may be barred due to improper payments in conjunction with the contract. DEMING, *supra* note 3, at 381. Over the years, arbitrators have asserted the existence of "an international public order which makes bribery contracts invalid and contrary to *bonos mores*." A. Timothy Martin, *International Arbitration and Corruption: An Evolving Standard*, INT'L ENERGY & MIN. ARB., MIN. LAW SERIES (2002). Some tribunals have found national laws to also hold such contracts illegal.

Until the recent adoption of the anti-bribery conventions, *see supra* note 2 and accompanying text, no specific reference to international law could be made. DEMING, *supra* note 3, at 381. That has now changed. There can be little question that an agreement to pay a bribe is contrary to customary international law and not just a breach of moral standards. Arbitrators can accordingly be expected to be more and more confronted with arguments of this nature by parties challenging the enforcement of a contract where allegations of improper payments exist. *Id.*

[7] 15 U.S.C. §§ 78dd-1, 78dd-2, 78dd-3.

[8] *Id.*

[9] *Id.* §§ 78m(b)(2), 78m(b)(4)-(7), 78ff(a).

[10] Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, § 102, 91 Stat. 1494.

[11] *See, e.g.*, DEMING, *supra* note 3, at 21; Arthur F. Matthews, *Defending SEC and DOJ FCPA Investigations and Conducting Related Corporate Internal Investigations: The Triton*

The two mechanisms are conceptually different from one another. The anti-bribery provisions are proscriptive whereas the accounting and record-keeping provisions are prescriptive in nature.[12] Their scope and application also differ. Each set of provisions must be considered separately, and neither provision should be considered alone.[13] They were intended to work in "tandem" and thereby complement one another.[14] A certain set of facts may suggest a violation of the anti-bribery provisions. At the same time, the same set of facts may not suggest a violation of the accounting and record-keeping provisions.

II. THE EXPANSIVE NATURE OF THE ACCOUNTING AND RECORD-KEEPING PROVISIONS

The FCPA's accounting and record-keeping provisions constitute the FCPA's second and less-known mechanism for deterring improper payments to foreign officials. While their application is ostensibly limited to issuers,[15] the accounting and record-keeping provisions constitute the far more potent mechanism. Unlike the anti-bribery provisions, they are not limited to the making of improper payments to foreign officials. The accounting and record-keeping provisions "have a much broader reach."[16] They apply to all aspects of the practices relating to the preparation of the financial statements of an entity subject to their terms.[17]

The accounting and record-keeping provisions go far beyond simply addressing the bribery of foreign officials. One of the problems disclosed by the revelations of the Watergate era in the United States was the accounting and record-keeping practices that made improper payments

---

Energy/Indonesia SEC Consent Decree Settlements, 18 NW. J. INT'L L. & BUS. 303, 349 (1998) (citing 2 KATHLEEN F. BRICKEY, CORPORATE CRIMINAL LIABILITY § 9:20, at 279 (1992)).

[12] DEMING, *supra* note 3, at 6.

[13] *Id.*

[14] S. REP. NO. 95-114, at 3, 7 (1977), *reprinted in* 1977 U.S.C.C.A.N. 4098. For example, the Senate report associated with the FCPA's passage stated that "a U.S. company 'which looks the other way' in order to be able to raise the defense that they were ignorant of bribes made by a foreign subsidiary, could be in violation of [the accounting and record-keeping provisions] requiring companies to devise and maintain adequate accounting controls." *Id.* at 11.

[15] *See infra* text accompanying notes 39-47, for discussion of what constitutes an issuer for purposes of the accounting and record-keeping provisions.

[16] THOMAS LEE HAZEN, 2 LAW OF SECURITIES REGULATION 348 (5th ed. 2005).

[17] See *infra* Section V, for discussion as to the scope of the record-keeping provisions, especially as they may relate to records not directly related to the preparation of financial statements.

possible.[18] To address these practices, the accounting and record-keeping provisions placed new and significant obligations on the worldwide operations of all entities subject to its terms to maintain records that accurately reflect transactions and dispositions of assets and to maintain systems of internal accounting controls.[19]

"Congress believed that almost all such bribery was covered up in the corporation's books, and that to require proper accounting methods and internal accounting controls would discourage corporations from engaging in illegal payments. Congress recognized that both investors and the corporation itself would benefit from accurate bookkeeping."[20]

> Although one of the major substantive provisions of the FCPA is to require corporate disclosure of assets as a deterrent to foreign bribes, the more significant addition of the FCPA is the accounting controls or "books and records" provision, which gives the SEC authority over the entire financial management and reporting requirements of publicly-held United States corporations.[21]

Congress recognized at the time of the FCPA's consideration that the accounting provisions would have an effect extending beyond "questionable payments" made in connection with foreign business.[22] The SEC report proposing the legislation concerning accounting and record-keeping practices, which was in large part ultimately adopted as part of the FCPA,[23] stated that questionable payments "cast doubt on the integrity and

---

[18] *See supra* note 4. One of the "key conclusions" drawn from the SEC investigations during that period was 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 which has been designed to assure that there is proper accounting of the use of corporate funds and that documents filed with the Commission and circulated to shareholders do not omit or misrepresent material facts. Millions of dollars of funds have been inaccurately recorded in corporate books to facilitate the making of questionable payments. Such falsification of records has been known to corporate employees and often to top management, but often has been concealed from outside auditors and counsel and outside directors.

Promotion of Reliability of Financial Information, *supra* note 4 (citing Report of the Securities and Exchange Commission on Questionable and Illegal Corporate Payments and Practices, *submitted to* S. Comm. on Banking, Hous. and Urban Affairs 3 (May 12, 1976) [hereinafter Questionable Payments Report]).

[19] *See* DEMING, *supra* note 3, at 21; Matthews, *supra* note 11, at 349.

[20] Lewis v. Sporck, 612 F. Supp. 1316, 1333 (N.D. Cal. 1985) (citing S. REP. NO. 95-114).

[21] Sec. & Exch. Comm'n v. World-Wide Coin Inv., Ltd., 567 F. Supp. 724, 746 (N.D. Ga. 1983).

[22] GARY LYNCH, ENFORCEMENT OF THE ACCOUNTING PROVISIONS OF THE FOREIGN CORRUPT PRACTICES ACT OF 1977, at 1 (1983), *reprinted in* 2 BUSINESS LAWS, INC. 260.001.

[23] Questionable Payments Report, *supra* note 18, at 63-69. The proposed language for a new § 78m(b)(2) was identical to what later became § 78m(b)(2) under § 102 of the FCPA.

reliability of the corporate books and records which are the very foundation for the disclosure system established by the federal securities laws."[24] The report went on to state that "[i]mplicit in the requirement to file accurate financial statements is the requirement that they be based on adequate and truthful books and records. The integrity of corporate books and records is essential to the entire reporting systems administered by the SEC."[25]

Critics of the accounting provisions recognized that the effect of the SEC's proposal would apply to more than foreign payments.[26] A representative of the American Institute of Certified Public Accountants testified that the SEC proposal

> goes far beyond the problem of illegal corporate payments in establishing a required corporate structure of corporate accountability and by making it illegal to distort proper recordkeeping. The proposed amendment would, for the first time, involve the SEC on a broad basis in corporate activities which do not involve filings with the Commission or transactions in securities.[27]

Despite these concerns, "Congress interjected itself into this process by establishing accounting standards for regulated companies and requiring them to implement a system of accounting controls to insure that the accounting standards are met."[28] The adoption of the accounting and record-keeping provisions "reflect[ed] a congressional determination that the scope of the federal securities laws and the SEC's authority should be expanded beyond the traditional ambit of disclosure requirements."[29]

That congressional determination as to the expansive nature of the accounting and record-keeping provisions has not waned over time. At the core of the heightened obligations under the Sarbanes-Oxley Act of 2002

Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, § 102, 91 Stat. 1494. While the proposed language for new §§ 78m(b)(3) and § 78m(b)(4) were not included in § 102, *id.*, both provisions, with one modification, later became Rules 13b2-1 and 13b2-2; *see* Promotion of Reliability of Financial Information, *supra* note 4. Unlike the proposed § 78m(b)(4), Questionable Payments Report, *supra* note 18, at 64, the modification restricted the application of Rule 13b2-2 to officers and directors. Exchange Act Release No. 13,185 [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,896, at 87,382 (Jan. 19, 1977). Indeed, the SEC proposed what later became Rules 13b2-1 and 13b2-1 nearly a year before the adoption of the FCPA. *See id.*; *cf. infra* note 103.

[24] Questionable Payments Report, *supra* note 18, at 3.

[25] *Id.*

[26] LYNCH, *supra* note 22, at 2.

[27] *Foreign Payments Disclosure: Hearings on H.R. 13481, S. 3664, H.R. 13870 and H.R. 13953 Before the Subcomm. on Consumer Prot. and Fin. of the H. Comm. on Interstate and Foreign Commerce*, 94th Cong. 18 (1976).

[28] Lewis v. Sporck, 612 F. Supp. 1316, 1329 (N.D. Cal. 1985).

[29] Sec. & Exch. Comm'n v. World-Wide Coin Inv., Ltd., 567 F. Supp. 724, 747 (N.D. Ga. 1983).

("Sarbanes-Oxley") are those that relate to the accounting and record-keeping provisions of the FCPA.[30] As a result of the adoption of Sarbanes-Oxley,[31] issuers are required to include in their annual reports an internal control report expressing management's responsibility for establishing and maintaining adequate internal controls for financial reporting and assessing their effectiveness.[32] An issuer's outside auditor is required to provide an attestation with management's assessment of the adequacy of the issuer's internal controls.[33] Sarbanes-Oxley also expanded the record-keeping provisions to address a broader range of conduct than simply a material misstatement or omission.[34]

Significantly, Sarbanes-Oxley increased the maximum penalty for a single criminal violation of the accounting and record-keeping provisions by an individual to twenty years.[35] Fines for a violation were increased to $5 million for an individual and $25 million for an entity.[36] In contrast, the penalties for a violation of the anti-bribery provisions are far less severe.[37]

---

[30] *See, e.g.*, Alan L. Beller, Director, Div. of Corp. Fin. U.S. Sec. & Exch. Comm'n, Speech by SEC Staff: Investors, the Stock Market, and Sarbanes-Oxley's New Section 404 Requirements (Jan. 12, 2005), *available at* http://www.sec.gov/news/speech/spch011205alb.htm.

[31] *See* Sarbanes-Oxley Act, Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified as amended in scattered sections of 15 U.S.C. and 18 U.S.C.).

[32] 15 U.S.C. § 7262(a) (2000 & Supp. 2005).

[33] *Id.* § 7262(b).

[34] *Id.* § 7242(a); see *infra* Section V.A.2, for a discussion of Rule 13b2-2, 17 C.F.R. § 240.13b2-2(b) (2005). In addition, informants were given added protection by Sarbanes-Oxley. It is now a criminal offense for any individual or entity to knowingly retaliate against any person for providing information relating to the commission or possible commission of a federal offense. 18 U.S.C. § 1513(e) (2000 & Supp. 2005). "Retaliation" under the statute can consist of "interfering with the lawful employment or livelihood" of an informant. *Id.* Along these same lines, new criminal statutes were added for the destruction, alteration, or falsification of records to impede a federal investigation or in anticipation of such an investigation and for the destruction of audit records in violation of rules and regulations promulgated by the SEC. *Id.* §§ 1519-20.

[35] 15 U.S.C. § 78ff(a). Initially, the maximum penalty was a maximum term of imprisonment of five years and fine of $100,000 for individuals and $500,000 for entities. It was later increased in 1988 to a maximum of ten years and $1 million fines for individuals and $2.5 million fines for entities. Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, § 4, 102 Stat. 4677, 4680. Sarbanes-Oxley raised the maximum penalties to their current levels. Sarbanes-Oxley Act § 1106, 116 Stat. at 810.

[36] 15 U.S.C. § 78ff(a).

[37] Violations of the accounting and record-keeping provisions are subject to the standard SEC enforcement consequences including injunctions, civil penalty actions, and administrative proceedings. *Id.* §§ 78u, 78u-3. Civil enforcement actions under the accounting and record-keeping provisions are subject to a civil penalty of $10,000. *Id.* § 78ff(c)(1)(B).

The maximum period of imprisonment for an individual is five years and the maximum fine for a criminal violation by an entity is $2 million.[38]

III. THE JURISDICTIONAL SCOPE OF THE ACCOUNTING AND RECORD-KEEPING PROVISIONS

The accounting and record-keeping provisions are narrower in the scope of their application than the anti-bribery provisions. They apply to issuers of securities, as defined by § 3 of the Securities Exchange Act of 1934 ("Exchange Act"),[39] which are required by the Exchange Act to register under § 12 or file reports under § 15(d) or which have filed a registration statement that has not yet become effective under the Securities Act of 1933.[40]

As a practical matter, unless otherwise exempted, an issuer subject to the terms of the accounting and record-keeping provisions includes the following categories of entities[41]:

- Entities with securities listed on a national securities exchange, including the National Association of Securities Dealers Automated Quotation System[42];
- Entities with assets in excess of $1 million and more than 500 shareholders and that are engaged in interstate commerce, in a business affecting interstate commerce, or whose securities are traded by use of the mails or any means or instrumentality of interstate commerce[43];
- Financial institutions that issue securities and that are insured in accordance with the Federal Deposit Insurance Act[44];
- Entities offering a registration statement that has not yet become effective under the Securities Act of 1933 and that has not been withdrawn[45];
- Foreign entities required to file reports under § 15(d) of the Exchange Act.[46]

---

[38] *Id.* §§ 78dd-2(g), 78dd-3(e), 78ff(c).

[39] *Id.* § 78c(a)(8).

[40] *Id.* §§ 77a-77c, 78o(d), 78l.

[41] Hereafter, unless otherwise indicated, the term "issuer" will be used in this article to refer to entities subject to the terms of the accounting and record-keeping provisions.

[42] 15 U.S.C. § 78l(b).

[43] *Id.* § 78l(g)(1)(B).

[44] *Id.* § 78l(i).

[45] *Id.* § 77a-77c.

[46] *Id.* § 78o(d).

In addition, at least with respect to keeping accurate books and records under the record-keeping provisions, an issuer can include a privately-held entity for the periods for which it is required to submit financial statements as part of a registration under the Exchange Act.[47]

A. FOREIGN ENTITIES

Issuers can include foreign entities that are required under the Exchange Act to register pursuant to § 12 or to file reports pursuant to § 15(d).[48] Issuers can also include foreign entities with American Depository Receipts ("ADRs") listed on a national exchange, including the NASDAQ.[49] ADRs represent an ownership interest in the securities of a foreign private issuer that are deposited, usually outside of the United States, with a financial institution as the depository.[50]

---

[47] United States v. Crop Growers Corp., 954 F. Supp. 335, 355-56 (D.D.C. 1997); *see* Matthews, *supra* note 11, at 392 ("[A] 'private' company that later (within two years) becomes a public company, can, by falsifying its 'private' books and records, trigger a subsequent criminal prosecution of the 'public' company for false books and records.").

[48] 15 U.S.C. §§ 78o(d), 78l. This can include foreign entities that do not intend to sell their securities in the United States:

> [A] foreign private issuer that has $10 million or more in assets at the end of its most recent fiscal year is required to register any class of equity securities if any such class is held of record by 500 or more persons worldwide, including 300 or more in the United States.

DONALD ZARIN, DOING BUSINESS UNDER THE FCPA 4-3, n. 7 (PLI 2004) (citing 15 U.S.C. § 78l(g); 17 C.F.R. §§ 12g3-2(a) (2001)). "A foreign issuer can avoid this registration requirement by applying for an exemption with the SEC under Rule 12g3-2(b) of the Exchange Act, 17 C.F.R. § 240.12g-3(b) (2001)." *Id.*

[49] ZARIN, *supra* note 48, at 4-3, n. 7.

[50] ADRs are negotiable certificates issued by a U.S. bank or trust company. Mark Saunders, *American Depositary Receipts: An Introduction to U.S. Capital Markets for Foreign Companies*, 17 FORDHAM INT'L L.J. 48, 49 (1993). Unless an exemption is available, ADRs must be registered under the Securities Act before they may be publicly distributed within the United States. 15 U.S.C. § 77(b)(1). "[T]he public offering of ADRs is no different than the public offering of ordinary shares in many respects, from a legal point of view." Frode Jensen, III, *The Attractions of the U.S. Securities Markets to Foreign Issuers and the Alternative Methods of Accessing the U.S. Markets: From a Legal Perspective*, 17 FORDHAM INT'L L.J. S25, S29 (1994). The legislative history of U.S. securities laws reflect the intent to treat foreign private issuers the same as domestic issuers. Saunders, *supra*, at 59 (citing R. Adee, *Offerings by Foreign Private Issuers, in* SECURITIES UNDERWRITING—PRACTITIONER'S GUIDE 413, 428 (K. Bialkin et al. eds, PLI 1985)). "[T]he more voluntary steps a foreign company has taken to enter U.S. capital markets, the degree of regulation and amount of disclosure more closely approaches the regulation of domestic registrants." *Id.* at 60 (quoting Integrated Disclosure System for Foreign Private Issuers, Securities Act Release No. 6360 [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,054, at 84,651 (Dec. 2, 1981)).

B. SUBSIDIARIES

Unlike the anti-bribery provisions, the accounting and record-keeping provisions apply directly to the operations of majority-owned foreign subsidiaries of an issuer.[51] However, the accounting and record-keeping provisions are not necessarily applicable to domestic or foreign entities if the issuer holds an interest of 50% or less in the foreign entity.[52] When an issuer does not have an interest greater than 50%, it must "proceed in good faith to use its influence to the extent reasonable under the circumstances to cause [the affiliate] to devise and maintain a system of internal accounting controls" consistent with the requirements of the accounting and record-keeping provisions.[53] In such circumstances, it will be "conclusively presumed" to have fulfilled its statutory obligation when it can demonstrate its good faith efforts to influence its subsidiary.[54]

In determining whether good faith efforts are exercised, the relevant circumstances "include the relative degree of the issuer's ownership of the domestic or foreign firm and the laws and practices governing the business operations of the country in which such firm is located."[55] The degree of effective control can be expected to bear directly on the evaluation of whether an issuer's efforts are sufficient to demonstrate good faith on its part.[56] An issuer's duty to influence a subsidiary's behavior increases

---

[51] 15 U.S.C. § 78m(b)(6). The anti-bribery provisions do not directly apply to foreign subsidiaries, including wholly-owned foreign subsidiaries. *See* H.R. REP. No. 95-831, at 14 (1977), *reprinted in* 1977 U.S.C.C.A.N. 4120. However, in the latter situation, a parent can be held vicariously liable for the conduct of a subsidiary if it has sufficient knowledge and in some way authorizes or acquiesces in the conduct of the foreign subsidiary. *See infra* Section IV; *cf.* H.R. REP. No. 95-831, at 14; S. REP. No. 95-114, at 11 (1977), *reprinted in* 1977 U.S.C.C.A.N. 4098.

[52] 15 U.S.C. § 78m(b)(6).

[53] *Id.*

[54] *Id.*

[55] *Id.*

[56] The House Conference Report associated with the 1988 amendments to the FCPA, Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418 §§ 5001-5003, 102 Stat. 1415-1425 [hereinafter OTCA Conf. Rep.], in explaining the addition of Section 13(b)(6) to the Exchange Act, explained,

> [T]hat it is unrealistic to expect a minority owner to exert a disproportionate degree of influence over the accounting practices of a subsidiary. The amount of influence which an issuer may exercise necessarily varies from case to case. While the relative degree of ownership is obviously one factor, other factors may also be important in determining whether an issuer has demonstrated good-faith efforts to use its influence.

H.R. REP. No. 100-576, at 917 (1988), *reprinted in* 1988 U.S.C.C.A.N. 1547, 1950.

directly with the degree to which it can exercise control over the subsidiary.[57]

C. CERTAIN INDIVIDUALS

In general, while acting within the scope of their employment or responsibilities on behalf an issuer, individuals, and in particular, officers, directors, employees, stockholders and agents of an issuer can be subject to the terms of the accounting and record-keeping provisions. Depending upon the circumstances, individuals can be directly subject to the terms of the accounting and recording-keeping provisions.[58] The one major exception relates to violations of Rule 13b2-2 relating to disclosures to auditors. Rule 13b2-2 is only directly applicable to officers and directors. Yet anyone acting on their behalf could be liable as an accomplice.[59]

---

[57] *Id.* The SEC has taken action where an issuer has less than 50% control. In *Sec. & Exch. Comm'n v. BellSouth Corp.*, BellSouth consented to the entry of judgment directing it to pay a $150,000 civil penalty for violating the FCPA's record-keeping and internal controls provisions. Litigation Release No. 17,310 (Jan: 15, 2002), *available at* http://www.sec.gov/litigation/litreleases/lr17310.htm. In the accompanying administrative proceeding, *In re* BellSouth Corp., Exchange Act Release No. 45,279 (Jan. 15, 2002), *available at* http://www.sec.gov/litigation/admin/34-45279.htm, BellSouth was found to have violated the internal control provisions. BellSouth's Nicaraguan subsidiary, Telefonia Celular de Nicaragua, S.A.'s ("Telefonia"), improperly recorded payments to the wife of a Nicaraguan legislator who chaired a committee with oversight over the legislation that would enable BellSouth to acquire a majority interest in Telefonia. *Id.* Initially, BellSouth purchased a 49% interest in Telefonia with an option to purchase another 40% interest. *Id.* However, Nicaraguan law prohibited foreign ownership of 50% or greater interest in telecommunication companies. *Id.* In spite of her lack of legislative experience, she was retained and ultimately paid $60,000. *Id.* BellSouth International, an indirectly wholly-owned subsidiary of BellSouth, knew that payments to the lobbyist could implicate the FCPA. *Id.* Nonetheless, a BellSouth International attorney approved Telefonia's retention of the legislator's wife. *Id.* BellSouth was found to have "held less than 50 percent of the voting power of Telefonia, but through its operational control, had the ability to cause Telefonia to comply with the FCPA's books and records and internal controls provisions." *Id.* BellSouth was found to have failed to devise and maintain a system of internal accounting controls at Telefonia sufficient to detect and prevent FCPA violations. *Id.* In terms of the adequacy of internl controls, including a compliance program, it should also be noted that BellSouth International officials "knew or should have known that the attorney lacked sufficient experience or training to enable him properly to opine on the matter." *Id.* In that same proceeding, BellSouth was also found to have violated the record-keeping provisions for actions on the part of its Venezuela subsidiary, Telcel, C.A. *Id.* Telcel recorded payments totaling $10.8 million to six offshore companies based on fictitious invoices for services rendered. *Id.* During the period, BellSouth had a majority interest in Telcel. *Id.*

[58] See *infra* Section V.A.1, for discussion of Rule 13b2-1.

[59] See *infra* Section IV.A.3, for discussion relative to being an accomplice, and Section IV.B.3, for discussion relative to aiding and abetting.

IV. VICARIOUS LIABILITY UNDER THE ACCOUNTING AND RECORD-KEEPING PROVISIONS

An individual or entity can be held vicariously liable for the conduct of a third party when the third party is acting for or on behalf of the individual or entity. Classic examples of third parties that can serve as a basis for third-party liability include agents, consultants, and representatives acting on behalf of an issuer. Even if a third party is not subject to the accounting and record-keeping provisions, an individual or entity can become subject to vicarious liability if the individual or entity authorizes, directs, or in some way ratifies conduct prohibited by the accounting and record-keeping provisions. Depending upon whether criminal or civil charges are brought, the knowledge requirement for establishing vicarious liability can vary dramatically.

A. CRIMINAL LIABILITY

In 1988, Congress clarified the knowledge requirement under the accounting and record-keeping provisions. Section 13(b) of the Exchange Act was amended to add the following provisions:

> (4) No criminal liability shall be imposed for failing to comply with the requirements of paragraph (2) of this subsection except as provided in paragraph (5) of this subsection.
>
> (5) No person shall knowingly circumvent or knowingly fail to implement a system of internal accounting controls or knowingly falsify any book, record, or account described in paragraph (2).[60]

For criminal liability to be imposed for acts of third parties, an issuer must have knowledge that the third party intends to circumvent or has circumvented the internal controls or falsified books and records.[61] Especially when an issuer becomes aware of the existence of questionable circumstances, as with the anti-bribery provisions and many other federal criminal statutes, proof of deliberate ignorance or knowing disregard can establish the requisite knowledge.[62] Depending upon the nature of the relationship and the surrounding circumstances, acquiescence can constitute

---

[60] OTCA Conf. Rep., *supra* note 56, § 5002; 102 Stat. at 1415; 15 U.S.C. §§ 78m(b)(4)-(b)(5).

[61] *Id.*

[62] *E.g.*, United States v. Jacobs, 475 F.2d 270, 287 (2d Cir. 1973), *cert. denied sub nom.* Lavelle v. United States, 414 U.S. 821 (1973); *see* United States v. Manrique Aribizo, 833 F.2d 244, 249 (10th Cir. 1987); United States v. Kaplan, 832 F.2d 676, 682 (1st Cir. 1987); United States v. Picciandra, 788 F.2d 39, 46 (1st Cir. 1986); United States v. McAllister, 747 F.2d 1273, 1275 (9th Cir. 1984).

authorization.[63] For example, conscious acquiescence to a series of unauthorized acts could be found to constitute authorization to engage in similar acts.[64]

1. *Knowledge on the Part of Juridical Entities*

The knowledge requirement under U.S. law for a juridical person—or entity—is distinctly different from that for a natural person. No one person within an entity has to have all of the requisite knowledge.[65] Nor is there a requirement that there be knowledge on the part of senior members of management.[66] Regardless of how disparate the knowledge may be within an entity, the collective knowledge of employees of the entity acting within the scope of their employment can serve as the basis for establishing knowledge under U.S. law.[67] In essence, the sum of the knowledge of an entity's officers, directors, employees, and agents, when acting within the scope of their employment or responsibilities, establishes knowledge on the part of an entity.[68]

Actions on the part of isolated members of management or on the part of low-level employees could expose an issuer to criminal liability under the accounting and record-keeping provisions. Even more likely is the prospect of employees or isolated members of management having

---

[63] *See, e.g.*, H. Lowell Brown, *Parent-Subsidiary Liability Under The Foreign Corrupt Practices Act*, 50 BAYLOR L. REV. 1, 34 (1998) (citing United States v. Wilshire Oil Co. of Tex., 427 F.2d 969, 971 (10th Cir. 1970); United States v. Armour & Co., 168 F.2d 342, 342-43 (3d Cir. 1948)); *cf.* United States v. Bright, 517 F.2d 584, 587 (2d Cir. 1975).

[64] *See, e.g.*, United States v. Paccione, 949 F.2d 1183, 1200 (2d Cir. 1991) (A corporation may be held criminally liable "for the conduct of its supervisory employees who had either intentionally disregarded the law or had acted with plain indifference to its requirements" (quoting United States v. Demauro, 581 F.2d 50, 54 (2d Cir. 1978)); *Armour & Co.*, 168 F.2d. at 342-43 (a corporation can be found liable for acts of its employees even where the corporation cautioned against such conduct but did not diligently check and eliminate such practices).

[65] *E.g.*, United States v. T.I.M.E-D.C., Inc., 381 F. Supp. 730, 738 (W.D. Va. 1974) ("[A] corporation cannot plead innocence by asserting that the information obtained by several employees was not acquired by any one individual employee who then would have comprehended its full import."); Joseph S. Hall, *Corporate Criminal Liability*, 35 AM. CRIM. L. REV. 549, 555 (1998) ("Federal courts have found corporations liable even when there was no single employee at fault.").

[66] *See, e.g.*, United States v. Basic Constr. Co., 711 F.2d 570, 573 (4th Cir.), *cert. denied*, 464 U.S. 956 (1983) (rejecting arguments that a corporation can only be accountable for acts of high managerial agents); United States v. Koppers Co., 652 F.2d 290, 298 (2d Cir. 1981).

[67] *See, e.g.*, United States v. Bank of New Eng., N.A., 821 F.2d 844, 856 (1st Cir. 1987); Riss & Co. v. United States, 262 F.2d 245, 250 (8th Cir. 1958).

[68] *E.g.*, *Bank of New Eng., N.A.*, 821 F.2d at 856 ("The aggregate . . . constitutes the corporation's knowledge of a particular operation.").

knowledge of prohibited conduct being undertaken by third parties on behalf of an issuer. In such circumstances, their failure to register an objection or to disavow the prohibited conduct may be interpreted as constituting an authorization or acquiescence on the part of the entity.[69]

2. *Agents*

Actions by an agent of an issuer or of an individual subject to the terms of the accounting and record-keeping provisions can subject the issuer or individual to vicarious liability. Basic agency principles apply. The critical factor is whether the agent is acting within the scope of his authority, or apparent authority, and for the benefit of the issuer or individual.[70] If a foreign entity is deemed to be an agent of an issuer, the issuer may be held vicariously liable for the record-keeping practices of the foreign entity.[71]

3. *Accomplices*

In a criminal context, to the degree that they may be complicit, privately-held entities and individuals not affiliated with an issuer can be held vicariously liable for violations of the accounting and record-keeping provisions. They do not need to be directly subject to the terms of the accounting and record-keeping provisions.

a. Aiding and Abetting

Vicarious liability can arise out of an individual's or entity's involvement as an accomplice under the federal aiding and abetting

---

[69] *See supra* note 64.

[70] *See, e.g., Basic Constr. Co.*, 711 F.2d at 572-73.

[71] "An issuer that learns that a controlled foreign affiliate may have engaged in questionable accounting and record-keeping practices has the same responsibilities as an issuer would have in learning of improper accounting and record-keeping practices of its own employees." DEMING, *supra* note 3, at 36. The questionable conduct "must be repudiated" in a clear and unambiguous manner. *Id.* Measures should be undertaken to determine what occurred and, where appropriate, take remedial action to prevent its recurrence. The response should be sufficient to satisfy enforcement officials as to the adequacy of the response should questions later arise. *Id.* In the absence of an adequate response, the questionable conduct may be deemed to have been ratified. *Id.*

An issuer with a non-controlling interest may become aware of the improper conduct on the part of its subsidiary. This is more likely to occur if the issuer is actively involved in the operations or activities of the affiliate. For example, by having its own representatives on the board of directors or as members of management, an issuer is more likely to have knowledge of what is taking place and, therefore, more likely to be viewed as authorizing the conduct in question. *Id.* at 33.

statute.[72] An individual's or entity's knowledge coupled with actions that aid or abet a violation can lead to criminal liability in connection with prohibited conduct on the part of a third party.[73] In essence, to be liable as an accomplice, an individual or entity must act with intent that the offense be committed.[74] Someone found guilty of aiding and abetting is punishable as the principal.[75] This would mean that an individual who aided and abetted a violation of the accounting and record-keeping provisions could be subject to twenty years of imprisonment.[76]

b. Conspiracy

A conspiracy is established when two or more persons combine or agree to violate a federal statute and an affirmative act is taken by one of the persons in furtherance of the conspiracy.[77] No offer or payment needs to be made, no record needs to be falsified, and no system of internal controls needs to be circumvented. The agreement to violate the accounting and record-keeping provisions combined with an overt act by one of the co-conspirators in furtherance of the conspiracy serve as the basis for the criminal charge.[78]

---

[72] 18 U.S.C. § 2 (2000). In discussing the proposed provision relating to prohibitions against falsification of accounting records and deceptions of auditors, the Senate Report made specific reference to "[c]oncepts of aiding and abetting" being applicable to these provisions. S. REP. NO. 95-117, at 9 (1977), *reprinted in* 1978 U.S.C.C.A.N. 3569. The House receded to the Senate in agreeing to these provisions with one unrelated modification. *See infra* note 103.

[73] *E.g.*, Nye & Nissen v. United States, 336 U.S. 613, 619 (1949) (quoting United States v. Peoni, 100 F.2d 401, 401 (2d Cir. 1938) (Hand, J.)); United States v. Martin, 920 F.2d 345, 348 (6th Cir. 1990).

[74] *See, e.g.*, United States v. Medina, 887 F.2d 528, 532 (5th Cir. 1989) (holding that in order to convict a defendant of aiding and abetting, the defendant must share the principal's intent and engage in some affirmative conduct to aid the venture); United States v. Pearlstein, 576 F.2d 531, 546 (3d Cir. 1978) ("[I]t is necessary that the alleged aider and abettor associate himself with the unlawful venture and participate in it with the intent that its illegal objective be attained.") (citing United States v. Crockett, 534 F.2d 589 (5th Cir. 1976)).

[75] *Medina*, 528 F.2d at 532.

[76] *See supra* text accompanying note 35.

[77] 18 U.S.C. § 371. An individual convicted of conspiracy can be subjected to a term of imprisonment of five years. *Id.*

[78] The implications for an individual or entity cannot be overstated. So long as the requisite knowledge exists, rather casual interchanges or seemingly insignificant acts have the prospect of forming a basis for a conspiracy or an aiding and abetting charge. Relatively insignificant activity can constitute an overt act in furtherance of a conspiracy. For example, acquiescence combined with other affirmative acts of a very minor nature, like sending an e-mail, could form the basis for allegations of conspiring to violate the record-keeping provisions. *See, e.g.*, United States v. Quinn, 403 F. Supp. 2d 57, 59-60 (D.D.C. 2005); *cf.*

B. CIVIL LIABILITY

Implicitly, in a civil context, the accounting and record-keeping provisions provide for vicarious liability based upon common law principles of agency and respondeat superior. Unlike the anti-bribery provisions, a civil enforcement action does not require knowledge to establish a violation of the accounting and record-keeping provisions.[79] An issuer can be held strictly liable for actions taken by an officer, director, employee, shareholder, or agent acting on behalf of the issuer. Civil liability can be established without proving that the issuer knew or even suspected wrongful conduct by someone acting within the scope of their duties or responsibilities and on behalf of the issuer.

1. Subsidiaries

As previously discussed,[80] an issuer can also be held vicariously liable for the conduct of a domestic or foreign subsidiary. When an issuer has an interest greater than 50%, it makes no difference whether the issuer lacks knowledge of the conduct that serves as the basis for a violation.[81] Where an issuer has an interest of 50% or less, an issuer can also be vicariously liable for conduct for which it has no knowledge if it can be demonstrated that an issuer has not proceeded "in good faith to use its influence, to the extent reasonable under the issuer's circumstances, to cause such domestic or foreign firm to devise and maintain a system of internal accounting controls consistent with [the accounting and record-keeping provisions]."[82]

2. Control Person Liability

Although contrary authority exists as to its applicability to SEC enforcement actions,[83] another theory of vicarious liability employed by the SEC is known as "control person" liability under § 20(a) of the Exchange

---

United States v. Civella, 648 F.2d 1167 (8th Cir. 1981), *cert denied*, 454 U.S. 867 (1981); Bartoli v United States, 192 F.2d 130 (4th Cir. 1951).

[79] Sec. & Exch. Comm'n v. Softpoint, Inc., 958 F. Supp. 846, 866 (S.D.N.Y. 1997) ("There is no scienter requirement; liability is predicated on 'standards of reasonableness.'" (citing Promotion of Reliability of Financial Information, *supra* note 4)).

[80] See *supra* Section III.B, for additional discussion relative to subsidiaries.

[81] *See* OTCA Conf. Rep., *supra* note 56, at 917.

[82] 15 U.S.C. § 78m(b)(6). "Such circumstances include the relative degree of the issuer's ownership of the domestic or foreign firm and the laws and practices governing the business operations of the country in which such firm is located." *Id.* By implication, these circumstances are not exclusive and may well include a number of other factors. OTCA Conf. Rep., *supra* note 56, at 917.

[83] Sec. & Exch. Comm'n v. Coffey, 493 F.2d 1304, 1318 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975).

Act.[84] Control person liability was enacted to "expand, rather than restrict, the scope of liability under the securities laws."[85] Control person liability does not supplant common law principles of agency and respondeat superior.[86] Congress defined control "in a broad fashion . . . to reach prospective wrongdoers, rather than to permit the escape of those who would otherwise be responsible for the acts of their employees."[87]

To establish control person liability, a primary violation by the controlled person must be established as well as control of the primary violator.[88] Culpability in some "meaningful sense" by the controlling person must also be established.[89] "Control over a primary violator may be established by showing that the defendant possessed 'the power to direct or cause the direction of the management and policies of a person, whether through ownership of voting securities, by contract, or otherwise.'"[90] Once a prima facie violation of § 20(a) is established, the burden shifts to the control person to demonstrate that he acted in good faith,[91] and that he "did not directly or indirectly induce the act or acts constituting the violation."[92]

---

[84] 15 U.S.C. § 78t(a); *see, e.g.*, Sec. & Exch. Comm'n v. First Jersey Sec., Inc., 101 F.3d 1450, 1472 (2d Cir. 1996). Control person liability has been alleged in enforcement actions brought by the SEC involving violations of the anti-bribery and accounting and record keeping provisions. In *Sec. & Exch. Comm'n v. Murphy*, the SEC filed a civil injunctive action against Douglas A. Murphy and David G. Kay, two former officers of an issuer, American Rice, Inc. Complaint, Sec. & Exch. Comm'n v. Murphy, No. H-02-2908 (S.D. Tex. July 30, 2002), *available at* http://www.sec.gov/litigation/complaints/comp17651.htm. Kay was alleged to have authorized over $500,000 in bribery payments to Haitian customs officials. *Id.* ¶¶ 1, 22-23, 25, 27. The scheme was directed by Kay and included preparing false shipping records and recording the bribe payments as routine business expenditures. *Id.* ¶¶ 1, 22-23, 29. Despite his knowledge or reckless disregard of Kay's activities and control over Kay, *id.* ¶¶ 1, 10, 30-31, 33, 35-36, Murphy took no action to stop the payments or the preparation of the false records. Murphy was alleged to be liable as a control person for Kay's conduct in violating the anti-bribery and record-keeping provisions of the FCPA. *Id.* ¶¶ 3, 39-42, 46.

[85] Sec. & Exch. Comm'n v. Management Dynamics, Inc., 515 F.2d 801 (5th Cir. 1975) (citing Myzel v. Fields, 386 F.2d 718, 737-39 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968)); Richardson v. MacArthur, 451 F.2d 35, 41-42 (10th Cir. 1971)).

[86] Paul F. Newton & Co. v. Tex. Commerce Bank, 630 F.2d 1111, 1119 (5th Cir. 1980).

[87] *Management Dynamics, Inc.*, 515 F.2d at 812-13 (citing H.R. REP. NO. 73-1383, at 26 (1934)).

[88] *First Jersey Sec., Inc.*, 101 F.3d at 1472 (citing Marbury Mgmt., Inc. v. Kohn, 629 F.2d 705, 715-16 (2d Cir. 1980)).

[89] Gordon v. Burr, 506 F.2d 1080, 1085 (2d Cir. 1974) (quoting Lanza v. Drexel & Co., 479 F.2d 1277, 1299 (2d Cir. 1973) (en banc)).

[90] *First Jersey Sec., Inc.*, 101 F.3d at 1472-73 (quoting from 17 C.F.R. § 240.12b-2 (1996)).

[91] *See Marbury Management, Inc.*, 629 F.2d at 716; *Burr*, 506 F.2d at 1086.

[92] 15 U.S.C. § 78(t) (2000).

3. *Aiding and Abetting*

An entity or individual can also be vicariously liable in a civil context for aiding and abetting a violation of the accounting and record-keeping provisions.[93] However, unlike an individual or entity directly subject to the accounting and record-keeping violations, an individual or entity must "knowingly provide substantial assistance" to be liable as an aider and abettor.[94]

V. THE SUBSTANTIVE PROVISIONS OF THE ACCOUNTING AND RECORD-KEEPING PROVISIONS

The accounting and record-keeping provisions require issuers to maintain accurate records of their transactions and of the disposition of their assets. Unlike the anti-bribery provisions, which apply only to transactions involving payments to foreign officials, the accounting and record-keeping provisions apply without regard to whether foreign conduct, foreign officials, or improper payments are involved. They apply to an issuer's domestic and foreign operations and create an affirmative duty on the part of issuers as well as officers, directors, employees, and agents or stockholders acting on the issuer's behalf.

The record-keeping provisions require an issuer to "make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer."[95] "Reasonable detail" is "such level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs."[96] In adopting the FCPA, the conferees added this qualification out of "concern that such a standard, if unqualified, might connote a degree of exactitude and precision which is unrealistic."[97]

---

[93] *Id.* § 78t(e).

[94] *Id.* Aiding and abetting has been alleged in a civil context in conjunction with violations of the anti-bribery and accounting and record keeping provisions. In *Sec. & Exch. Comm'n v. Murphy*, Kay was alleged to have aided and abetted American Rice's violations of the internal control provisions and Murphy and Kay were alleged to have aided and abetted a violation of the anti-bribery provisions. Complaint at ¶¶ 48-49, Sec. & Exch. Comm'n v. Murphy, No. H-02-2908 (S.D. Tex. July 30, 2002), *available at* http://www.sec.gov/litigation/complaints/comp17651.htm.

[95] 15 U.S.C. § 78m(b)(2)(A).

[96] *Id.* § 78m(b)(7).

[97] H.R. REP. NO. 95-831, at 10 (1977), *reprinted in* 1977 U.S.C.C.A.N. 4120.

Under the accounting section no off-the-books fund could be lawfully maintained, either by a U.S. parent or by a foreign subsidiary, and no improper payment could be lawfully disguised.[98]

> Whether or not a particular situation involves bribery by the corporation or by an individual acting on his own will depend on all the facts and circumstances, including the position of the employee, the care with which management supervises employees in sensitive positions and its adherence to the *strict* accounting standards set forth under [the accounting and record-keeping provisions].[99]

A. FALSIFICATION OF BOOKS AND RECORDS

Under the record-keeping provisions of the FCPA, an issuer's management has the responsibility of ensuring that its books and records are accurate so that financial statements can be prepared in conformity with accepted methods of recording economic events.[100]

> The "books and records" provision, contained in section 13(b)(2)(A) of the FCPA has three basic objectives: (1) books and records should reflect transactions in conformity with accepted methods of reporting economic events, (2) misrepresentation, 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 and other criteria applicable to such statements.[101]

In carrying out the terms of record-keeping provisions of the FCPA, the SEC adopted two rules to strengthen the accuracy of corporate books and records and the reliability of the audit process.[102] Congress was aware of the SEC's intention to implement these rules prior to adopting the FCPA.[103]

---

[98] S. REP. NO. 95-114, at 11 (1977), *reprinted in* 1977 U.S.C.C.A.N. 4098.

[99] *Id.* (emphasis added).

[100] *See* H.R. REP. No. 95-831, at 10 (1977), *reprinted in* 1977 U.S.C.C.A.N. 4120.

[101] *Id.* at 748 (citing Committee on Corporate Law and Accounting, American Bar Association, *A Guide to the New Section 13(b)(2) Accounting Requirements of the Securities Exchange Act of 1934*, 34 BUS. LAW. 307 (1978) [hereinafter Guide]).

[102] *Cf.* S. REP. NO. 95-114, at 7 (1977), *reprinted in* 1977 U.S.C.C.A.N. 4098.

[103] The legislative history indicates that Congress was aware of the SEC's intention to implement rules prohibiting the falsification of books and records and making false statements to accountants:

> The Senate bill contained provisions to make it unlawful for (1) any person to knowingly falsify any book, record, or account required to be made for any accounting purpose, and (2) any person knowingly to make a materially false or misleading statement or to omit to state or cause another person to omit any material fact necessary in order to make statement to an accountant not misleading.

1. Rule 13b2-1

Rule 13b2-1 prohibits the falsification of books and records required to be kept under the record-keeping provisions.[104] It states 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."[105] It applies to "any person" and is not limited to officers and directors of a company or anyone acting on behalf of an issuer.[106]

> The House amendment contained no comparable provisions because the SEC had already published for comment rules designed to accomplish similar objectives under its existing authority.
>
> The Senate receded to the House. Although these provisions were supportive of the basic accounting section, the use of the "knowingly" standard has become involved in an issue never intended to be raised or resolved by the Senate bill – namely, whether or not the inclusion or deletion of the word "knowingly" would or would not affirm, expand, or overrule the decision of the Supreme Court in *Ernst & Ernst v. Hockfelder* (425 U.S. 185). As stated clearly in the Committee report on S. 305, these provisions were to be severable from the rest of the securities laws.
>
> Under the circumstances, the conferees determined the best method of proceeding was to retain only new section 13(b)(2) of the Securities Exchange Act of 1934. The conferees further decided that this legislation should not be converted into a debate on the important issues raised by the *Hochfelder* decision.
>
> In deleting the Senate provisions, the conferees intend that no inference should be drawn with respect to any rulemaking authority the SEC may or may not have under the securities laws.

H.R. REP. No. 95-831, at 10-11.

[104] 17 C.F.R. § 240.13b2-1 (2005).

[105] *Id.*

[106] SEC. v. Softpoint, Inc., 958 F. Supp. 846, 865-66 (S.D.N.Y. 1997). The addition of § 13(b)(5) to the Exchange Act in the 1988 Amendments resolves any question as to the application of the accounting and record-keeping to any person. *See* Matthews, *supra* note 11, at 350-51. Section 13(b)(5) provides that "[n]o person shall knowingly circumvent or knowingly fail to implement a system of internal accounting controls or knowingly falsify any book, record, or account described in [§ 13(b)(2)]." 15 U.S.C. § 78m(b)(5) (2000). In implementing the record-keeping provisions, the SEC found that

> [t]he effect of falsifications of books, records or accounts, in making reports required under Section 13 misleading or incomplete, is not necessarily contingent on the identity of the wrongdoers or on whether he acts with the knowledge or acquiescence of management. Moreover, while normally only officers and employees of the issuer are in a position to falsify corporate records, it is not feasible to identify in the Rule all categories of persons who might violate it. Consequently, the Commission believes that the rule should apply to any person who, in fact, does cause corporate books and records to be falsified.

Promotion of Reliability of Financial Information, *supra* note 4.

"The SEC has consistently taken the position that it can bring civil and administrative enforcement actions against individuals who 'cause' an issuer to violate Section 13(b)(2)." Matthews, *supra* note 11, at 351 (citing Sec. & Exch. Comm'n v. Triton Energy Corp., Litigation Release No. 15,266 (Feb. 27, 1997), *available at* http://www.sec.gov/litigation/

The accounting and record-keeping provisions do not actually define what is meant by "records." The definition of records contained in the Exchange Act is often used as the point of reference. It defines "books and records" to include "accounts, correspondence, memoranda, tapes, discs, papers, books, and other documents or transcribed information of any type, whether expressed in ordinary or machine language."[107] However, that definition does not provide guidance as to whether records totally unrelated to the preparation of financial statements may still be implicated by the accounting and record-keeping provisions.[108]

In the legislative history of the accounting and record-keeping provisions, the Senate version was largely adopted in conference with the only addition of the qualification that the accuracy of the record be in "reasonable detail."[109] In discussing the proposed legislation, the Senate Report included a footnote suggesting the breadth of application of the record-keeping provisions:

> The phrase "disposition of its assets" is not intended as a limitation on the scope of the requirement that accurate books and records be maintained. The issuer's responsibility to keep records correctly reflecting the status of its liabilities and equities is no less than its obligation to maintain such records concerning its assets. The word "transactions" in the bill encompasses accuracy in accounts of every character.[110]

In implementing the FCPA, the SEC recognized that the accounting and record-keeping provisions were "*not* exclusively concerned with the

---

litreleases/lr15266.txt; Sec. & Exch. Comm'n v. Triton Energy Corp., Litigation Release No. 15,396 (June 26, 1997), *available at* http://www.sec.gov/litigation/litreleases/lr15396.txt; *In re* Gore, Exchange Act Release No. 38,343 (Feb. 27, 1997), *available at* http://www.sec.gov/litigation/admin/3438343.txt). The rule has been extended to "'outsiders' as customers and suppliers." *See* Matthews, *supra* note 11, at 352 (citing *In re* Ngai King Tak, Exchange Act Release No. 7443 (Aug. 28, 1997), *available at* http://www.sec.gov/litigation/admin/3438988.txt; Sec. & Exch. Comm'n. v. Mangel, Litigation Release No. 15,465, (Aug. 28, 1997), *available at* http://www.sec.gov/litigation/litreleases/lr15465.txt; *In re* Kuntz, Exchange Act Release No. 36,281, 1995 SEC LEXIS 2490 (Sept. 26, 1995); Sec. & Exch. Comm'n v. Excal Enterprises, Inc., Litigation Release No. 14,651 (Sept. 21, 1995), *available at* http://www.sec.gov/litigation/litreleases/lr14651.txt; *In re* Richard D. Russell, Exchange Act Release No. 36,280, 1995 SEC LEXIS 2489 (Sept. 26, 1995)).

[107] 15 U.S.C. § 78c(a)(37) (2000 & Supp. 2005).

[108] For example, a question could arise as to whether a record not directly related to the preparation of financial statements, such as records relative to the maintenance of equipment, are subject to the accounting and record-keeping provisions. *See infra* note 115.

[109] H.R. REP. NO. 100-576, at 917 (1988), *reprinted in* 1988 U.S.C.C.A.N. 1547, 1950. *See* 15 U.S.C. § 78m(b)(7); Sec. & Exch. Comm'n v. World-Wide Coin Inv., Ltd., 567 F. Supp. 724, 749 (N.D. Ga. 1983) ("The only express congressional requirement for accuracy is the phrase 'in reasonable detail.'").

[110] S. REP. NO. 95-114, at 7 n.5 (1977), *reprinted in* 1977 U.S.C.C.A.N. 4098.

preparation of financial statements."[111] It noted that "[a]n equally important objective . . . [was] the goal of corporate accountability."[112]

Commentators are in accord that, at the very least, the record-keeping provisions apply to records that are relevant to the preparation of financial statements.[113] However, there is case law that states that "Congress' use of the term 'records' suggests that virtually any tangible embodiment of information made or kept by an issuer is within the scope of section 13(b)(2)(A) of the FCPA, such as tape recordings, computer print-outs, and similar representations."[114]

No categorical statement can be made as to what records are beyond the purview of the record-keeping provisions. The particular circumstances will ultimately dictate what records are subject to their terms.[115] But in general, the greater the degree to which a record may relate to the preparation of financial statements, the adequacy of internal controls, or the performance of audits,[116] the more courts are likely to find the record to be

---

[111] Promotion of Reliability of Financial Information, *supra* note 4.

[112] *Id.*

[113] *See* Exchange Act Release No. 15,570, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,959 (Feb. 15, 1979); STEPHEN F. BLACK & ROGER M. WITTEN, COMPLYING WITH THE FOREIGN CORRUPT PRACTICES ACT § 6.03[1], at 6-7; *ABA Symposium, Practical Implications of the Accounting Provisions of the Foreign Corrupt Practices Act of 1977, and Recent Developments: A Program by Committee on Corporate Law and Accounting*, 35 BUS. LAW. 1713, 1726-30 (1980) (comments of Edward D. Herlihy, Assistant Dir., Sec. & Exch. Comm'n. Div. of Enforcement); Mary Jane Dundas & Barbara George, *Historical Analysis of the Accounting Standards of the Foreign Corrupt Practices Act*, 10 MEM. ST. U. L. REV. 499 (1980); Mary Jane Dundas & Barbara George, *Responsibilities of Domestic Corporate Management Under the Foreign Corrupt Practices Act*, 31 SYRACUSE L. REV. 865 (1980); Matthews, *supra* note 11, at 353 (citing *Guide*, *supra* note 102, at 313); Siedel, *Internal Accounting Controls Under the Foreign Corrupt Practices Act: A Federal Law of Corporations?*, 18 AM. BUS. L.J. 444, 459-65 (1981).

[114] *World-Wide Coin Inv., Ltd.*, 567 F. Supp. at 748-49.

[115] As an example, without some relationship to the preparation of financial statement, records relating to the maintenance of equipment are less likely to fall within the scope of the record-keeping provisions. However, that assessment could dramatically change if the maintenance costs were significant or if the nature of the maintenance being performed was essential to ensuring the reliability of equipment vital to the operation of a business. *Cf. id.* at 749 ("As a practical matter, the standard of accuracy in records will vary with the nature of the transaction involved.").

[116] *Cf.* S. REP. NO. 95-114, at 7 (1977), *reprinted in* 1977 U.S.C.C.A.N. 4098 ("The purpose of the [accounting and record-keeping provisions is to strengthen the accuracy of the corporate books and records and the reliability of the audit process . . . ."). Given Sarbanes-Oxley's emphasis on internal controls and deterring conduct that might impede or affect the audit function, *see supra* Section II, by inference Congress has reaffirmed the broad scope of records subject to the terms of the accounting and record-keeping provisions.

subject to the terms of the record-keeping provisions.[117] Records such as corporate minutes, transactional documents, authorizations for expenditures are all incidental to the preparation of financial statements or recording economic events.[118] They also directly relate to internal controls and audits of financial statements.

Consistent with the statute's accounting and record-keeping provisions,[119] Rule 13b2-1 contains no materiality requirement.[120] Rule 13b2-1 provides "an independent basis for enforcement action . . ., whether or not violation of the provisions may lead, in a particular case, to the dissemination of materially false or misleading information to investors."[121] "Even if the amount of a payment would not affect the 'bottom line' of an issuer in quantitative terms, it could still constitute a violation of the record-keeping provisions if not accurately recorded. The record-keeping provisions apply to all payments, not merely sums that would be material in the traditional financial sense."[122]

This represents a dramatic departure from the traditional approach taken by U.S. securities laws. Historically, except for disclosures as to certain aspects of an issuer's activities,[123] materiality was the overriding consideration as to what required disclosure and what constituted a violation. But as a result of the record-keeping provisions, relatively insignificant amounts of money, if not properly recorded, can have serious ramifications.[124]

Similarly, the manner in which information is entered into an issuer's records can become very important under Rule 13b2-1. Manipulating an entity's books or records to mask transactions by characterizing them in some oblique way, or by actually falsifying a transaction, can lead to

---

[117] BLACK & WITTEN, *supra* note 114, § 6.03[1] at 6-8.

[118] *Id.*

[119] 15 U.S.C. § 78m(b)(2)(A) (Supp. 2005).

[120] *World-Wide Coins Inv. Ltd.*, 567 F. Supp. at 749.

[121] Promotion of Reliability of Financial Information, *supra* note 4.

[122] DEMING, *supra* note 3, at 22.

[123] For example, until the adoption of the FCPA, one of the relatively few exceptions to the materiality requirement related to related-party transactions involving family members. Item 404(a) of Regulation S-K provides that any transaction worth over $60,000 involving a director or his immediate family must be disclosed. *See* 17 C.F.R. § 229.404(a) (2005).

[124] When a violation of the anti-bribery provisions may be involved, the SEC has "zero" tolerance when record-keeping violations are also involved. Gregary S. Bruch, Assistant Dir., Div. of Enforcement, Sec. & Exch. Comm'n, Remarks at the American Conference Institute's Ninth National Foreign Corrupt Practices Act Program (Dec. 3, 2001).

serious exposure for an issuer and those individuals involved.[125] For example, placing a transaction into an abnormal category or "burying" it in some other way could serve as a basis for an enforcement action for a violation of Rule 13b2-1.[126]

2. *Rule 13b2-2*

Rule 13b2-2 prohibits any officer or director from making materially false or misleading statements or failing to state any material facts in the preparation of filings required by the Exchange Act.[127] Officers and directors of an issuer, or anyone acting on their behalf, are prohibited from "taking any action to fraudulently influence, coerce, manipulate, or mislead any independent public or certified accountant engaged in the performance

---

[125] While the provisions of Rule 13b2-1 have broad application to the books and records of an issuer, "enforcement officials have less tolerance for inaccurate records that may bear more directly on compliance obligations of an issuer." DEMING, *supra* note 3, at 23. The context in which a record may have been falsified, such as concealment of a violation of law or the true financial status of an issuer, will be critical factors in a determination as to whether enforcement action will be taken for a violation of Rule 13b2-1. DEMING, *supra* note 3, at 23; *cf. infra* notes 126, 144 and accompanying text.

[126] Facilitating payments provide a classic example of the interplay between the accounting and record-keeping provisions and the anti-bribery provisions. For example, facilitating payments, which are permitted under the anti-bribery provisions, 15 U.S.C. §§ 78dd-1(b), 78dd-2(b), 78dd-3(b) (2000 & Supp. 2005), could pose a problem if not accurately described. An effort to conceal facilitating payments by placing them among other types of payments would be improper. DEMING, *supra* note 3, at 23. It is the improper classification that would be false and which could serve as a basis for a violation.

If a facilitating payment represents a relatively small amount of money and has no relationship to any particular function of an entity, its inclusion in a category of miscellaneous items may not be inappropriate. *Id.* at 24. Its classification is not necessarily inaccurate or false. "Similarly, the degree to which the facilitating payments may be rolled up into larger line items and thereby hidden is not necessarily improper as long as the manner in which such payments are incorporated into a larger line item is logical and not for the purpose of concealing questionable transactions." *Id.* The classification is not necessarily false or inaccurate. It is mere circumstance that leads to the facilitating payment being, in effect, "buried." But should the payment be incorrectly classified so that it may be rolled up into a larger line item and thereby concealed, then there may be a basis to allege a violation of the record-keeping provisions. *Id.*

Considerations relative to adequate internal controls also relate to facilitating payments. *Id.* If the facilitating payments are not properly approved or recorded, an issuer opens itself up to possible allegations of inadequate internal controls. *Id.* Indeed, for an issuer extensively engaged in international business, the failure to have a compliance program may constitute a violation of the internal control provisions of the accounting and record-keeping provisions. *See infra* note 166.

[127] 17 C.F.R. § 240.13b2-2(b) (2005).

of an audit of the financial statements of that issuer for the purpose of rendering such financial statements materially misleading."[128]

While this rule applies only to officers and directors, it extends to written and oral statements made to internal auditors as well as to outside auditors.[129] It also extends to "causing another person to make a material misstatement or make or cause to be made a materially false or misleading statement."[130] Not only are misrepresentations covered, but a material omission or failure to clarify a statement so as not to make it materially false or misleading can constitute a violation of Rule 13b2-2.

B. THE INTERNAL ACCOUNTING CONTROLS PROVISIONS

To enhance corporate accountability and ensure that boards of directors, officers, and shareholders of issuers are aware of and thus able to prevent the improper use of an issuer's assets, the accounting provisions require issuers to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurance that

- transactions are executed in accordance with management's general or specific authorization;
- transactions are recorded as necessary to permit the preparation of financial statements in conformity with generally accepted

---

[128] 15 U.S.C § 7242; 17 C.F.R. § 240.13b2-2(b). For the purposes of the Exchange Act and rules promulgated thereunder, "the term 'officer' means a president, vice president, secretary, treasury or principal financial officer, comptroller or principal accounting officer, and any person routinely performing corresponding functions with respect to any organization whether incorporated or unincorporated." Sec. & Exch. Comm'n v. Gallagher, No. 87-3904, 1989 U.S. Dist. LEXIS 9556, at *22 n. 10 (E.D. Pa. 1989).

[129] In implementing Rule 13b2-2, the SEC limited the application to officers and directors but declined to limit its application to written statements. Promotion of Reliability of Financial Information, *supra* note 4. It should be added that the combination of management's disclosure obligations under Rule 13b2-2 and an auditor's obligation to inquire under § 10A of the Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78j-1, and Statement of Auditing Statements ("SAS") No. 99, Codification of Statements on Auditing Standards, 1 AICPA PROFESSIONAL STANDARDS § 316 (2005) [heinafter AU], "may effectively eviscerate the protections of the attorney-client privilege, the attorney work product doctrine, and other similar protections." DEMING, *supra* note 3, at 381. If auditors are carrying out their responsibilities under § 10A and SAS No. 99, audits must be designed to detect illegal conduct. 15 U.S.C. § 78j-1; AU § 316.15. Questions can be expected to be asked as to whether management has knowledge of illegal acts and as to where illegal conduct is most likely to occur. AU at § 333.06. Since management controls the attorney-client privilege, "it is presented with the dilemma of disclosure of unfavorable information, and its consequences, or facing civil and possibly criminal charges for violating Rule 13b2-2 for failing to make required disclosures." DEMING, *supra* note 3, at 381.

[130] 17 C.F.R § 240.13b2-2.

accounting principles or any other criteria applicable to such statements, and to maintain accountability for assets;

- access to company assets is permitted only in accordance with management's general or specific authorization; and
- the recorded accountability for assets is compared with existing assets at reasonable intervals and appropriate action is taken with respect to any differences.[131]

The purpose of an accounting control system is to ensure that entities adopt accepted methods of recording economic events, protecting assets, and conforming transactions to management's authorization.[132] The accounting provisions do not mandate any particular kind of internal accounting controls.[133] The standard for compliance is whether a system, taken as a whole, reasonably meets the statute's objectives.[134] "Reasonable assurance" of management control over an issuer's assets means "such level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs."[135] "Like the record-keeping provisions, the internal controls provisions are not limited to material transactions or to those above a specific dollar amount."[136] However, "the prudent man qualification" was adopted in 1988 in order to clarify that accounting and record-keeping provisions do not "connote an unrealistic degree of exactitude or precision."[137]

---

[131] 15 U.S.C. § 78m(b)(2)(B).

[132] *See* H.R. REP. NO. 95-831, at 10 (1977), *reprinted in* 1977 U.S.C.C.A.N. 4120.

[133] *See id.* There is therefore a natural and intended interplay between the anti-bribery and the accounting and recording-keeping provisions. *See* S. REP. NO. 95-114 (1977), *reprinted in* 1977 U.S.C.C.A.N. 4098. "An effective system of internal accounting controls includes a range of review and approval guidelines designed to detect and to deter questionable payments. Indeed, the planning, implementation, and monitoring of an issuer's compliance program should be closely linked if not intertwined with its system of internal accounting controls." DEMING, *supra* note 3, at 351.

[134] DEMING, *supra* note 3, at 25.

[135] 15 U.S.C. § 78m(b)(7).

[136] Sec. & Exch. Comm'n v. World-Wide Coin Inv., Ltd., 567 F. Supp. 724, 749 (N.D. Ga. 1983).

[137] H.R. REP. NO. 100-576, at 917 (1977), *reprinted in* 1977 U.S.C.C.A.N. 4120, 1950. "The concept of reasonableness of necessity contemplates the weighing of a number of relevant factors, including the costs of compliance." *Id.*

VI. ENFORCEMENT OF THE ACCOUNTING AND RECORD-KEEPING PROVISIONS

Both the SEC and U.S. Department of Justice may bring actions for violations of the FCPA.[138] The SEC, with regulatory authority over issuers, may bring civil actions for violations of the anti-bribery provisions and for violations of the accounting and record-keeping provisions.[139] The Department of Justice may prosecute criminal violations of the FCPA and may bring civil actions against individuals and entities that are not subject to the SEC's jurisdiction.[140] An issuer's employees and agents can be prosecuted regardless of whether the company has been charged or convicted.[141]

A. CRIMINAL ENFORCEMENT

The accounting and record-keeping provisions have been used to buttress charges under the anti-bribery provisions.[142] The critical factor

---

[138] *See, e.g.*, S. REP. NO. 95-114, at 11-12.

[139] 15 U.S.C. §§ 78ff(c)(1)(B), 78ff(c)(2)(B), 78u, 78u-3.

[140] *Id.* §§ dd-2(d), dd-3(d); *see, e.g.*, S. REP. NO. 95-114, at 11-12.

[141] Matthews, *supra* note 11, at 323. Similarly, an entity's acquittal does not necessarily exonerate an individual who may be charged with the same offenses. Previously, under the anti-bribery provisions, there was a provision, commonly referred to as the "Eckhardt amendment," which precluded a finding of liability on the part of an individual if the entity was not also charged and convicted. United States v. McLean, 738 F.2d 655, 659 (5th Cir. 1984). "A major objective of the Eckhardt amendment [was] to allow the employee the benefit of the superior resources of the corporation in presenting a defense in the criminal proceeding; a closely related objective is to prevent the employer from making its employee a scapegoat." *Id.* The Eckhardt amendment was repealed as part of the 1988 amendments. H.R. REP. NO. 100-576, at 923.

[142] In a recent case, *United State v. Titan Corp.*, Titan pled guilty to violating both anti-bribery and record-keeping provisions of the FCPA as well as to assisting in the filing of a false tax return in violation of 26 U.S.C. § 7206(2) (2000). Plea Agreement, United States v. Titan Corp., No. 05CR0314 (S.D. Cal. Mar. 1, 2005), *reprinted in* 5 BUSINESS LAWS, INC. (FCPA) 699.9287. Titan was an issuer which, along with its subsidiaries, was involved in constructing wireless telephone systems in certain developing countries. *Id.* ¶ 1. The subsidiaries, including foreign subsidiaries, "shared employees, officers, and personnel with Titan" and, with the knowledge of Titan, entered into a business relationship with the President of Benin's business advisor. *Id.* ¶¶ 3, 7-8. Titan failed to conduct any formal due diligence regarding its agent in Benin "before or after engaging him." *Id.* ¶ 7. It also made payments without any evidence that the services were actually performed or the expenses actually incurred. *Id.* ¶ 10. At the direction of one senior Titan officer based in the United States, Titan funneled approximately $2 million, through its agent in Benin, towards the election campaign of Benin's President. *Id.* ¶¶ 17-23, 30. Titan made the payments to assist its development of a telecommunications project in Benin and to obtain the Benin government's consent to an increase in the percentage of Titan's project management fees for that project. *Id.* ¶¶ 4, 6. Titan violated the record-keeping provisions by falsely

with the accounting and record-keeping provisions is that the transaction need not be material.[143] In almost every instance, it is unlikely that the payment of bribes will be accurately reported. For this reason, the Department of Justice can be expected to look to the accounting and record-keeping provisions when investigating and ultimately charging an issuer for violating the anti-bribery provisions.[144]

One practical consideration in prosecuting violations of the anti-bribery provisions is the difficulty in securing evidence in a foreign setting. This difficulty is further complicated by whether such evidence would be admissible in a U.S. court. However, in the context of prosecuting a violation of the record-keeping provisions, the evidence is more likely to be documentary in nature and to be in the possession of an issuer subject to compulsion by U.S. enforcement authorities.

Even more important, proving a violation of the record-keeping provisions is more straightforward and more likely to succeed than proving a violation under the anti-bribery provisions. The evidence necessary to establish a violation is much simpler and less likely to confuse a jury. Unlike the anti-bribery provisions, there is no need to prove "corrupt intent," to prove whether a "foreign official" was involved, or to prove whether a promise, offer, or payment was made to "obtain or retain business." In large part, the elements of the offense are limited to whether the record is subject to the record-keeping provisions, whether the conduct was willful, and whether the record was accurate in reasonable detail.[145]

In other contexts, prosecutors have historically preferred charges for making false statements to the government because they are much easier to prove to a jury.[146] The evidence required to prove a false statement is likely to be much more clear cut and less susceptible to differing interpretations. The evidence is also likely to be documentary in nature and therefore less dependent upon recollections that can be subjective and that can fade over

---

characterizing the payments to its agent in Benin as "social payments." *Id.* ¶ 30.

[143] *Supra* notes 119-124 and accompanying text.

[144] S. REP. NO. 95-114, at 11 ("Under the accounting section no off-the-books accounting fund could be lawfully maintained, either by a U.S. parent or by a foreign subsidiary, and no improper payment could be lawfully disguised.").

[145] *Cf.* United States v. Wilson, No. 01 CR. 53 (DLC), 2001 U.S. Dist. LEXIS 9572, at *19 (S.D.N.Y. July 13, 2001).

[146] There are five elements to proving a false statement to a federal agency in violation of 18 U.S.C. § 1001 (2000): (1) the defendant made a statement; (2) the statement is false or fraudulent; (3) the statement is material; (4) the defendant made the statement knowingly and willfully; and (5) the statement pertained to an activity within the jurisdiction of a federal agency. *E.g.*, United States v. Steele, 933 F.2d 1313, 1318-19 (6th Cir. 1991).

time. Similarly, in tax prosecutions, the filing of a false tax return is much easier to prove than tax evasion.[147]

But unlike a case involving false statements to the government or the filing of a false tax return, charging a criminal violation of the record-keeping provisions is extraordinarily potent. From a prosecutor's perspective, a criminal violation of the record-keeping provisions has an added strategic advantage because it carries a far more severe penalty. A prosecutor does not need to complicate his or her case with additional charges, like money laundering,[148] in order to secure leverage for negotiations concerning cooperation or the entry of a plea.

In their own right, the FCPA's record-keeping provisions provide a completely independent basis for prosecuting those involved in making improper payments.[149] No requirement exists for violations of the record-

---

[147] Proof of the filing of a false return only requires proof that the person filing the return believed that it "was not true and correct as to every material matter." 26 U.S.C. § 7206(1) (2000). In contrast, tax evasion, 26 U.S.C. § 7201 (2000), requires proof of willfulness, the existence of a tax deficiency, and an affirmative act constituting an evasion or attempted evasion of the payment of the tax. Sansone v. United States, 380 U.S. 343, 351 (1965).

[148] For example, a violation of one of the money laundering statutes where a violation of the FCPA can serve as a predicate act can lead to a term of imprisonment of 20 years. 18 U.S.C. § 1956 (2000 & Supp. 2005).

[149] In *United States v. Cantor*, Information, Case No. 01 CR 687 (S.D.N.Y., July 18, 2001), *reprinted in* BUSINESS LAWS, INC. (FCPA) § 699.821601, the former president of American Banknote Holographics, Inc. ("ABNH"), a wholly-owned subsidiary of American Banknotes Corporation ("ABN"), an issuer, was charged with conspiring to inflate the reported financial condition of ABN and ABHN, *id.* ¶¶ 1-34, with falsifying books and records, *id.* ¶¶ 35-36, with making false statements to auditors, *id.* ¶¶ 37-38, and with conspiring to violate the anti-bribery provisions of the FCPA. *Id.* ¶¶ 37-54. The conspiracy to inflate ABN's and ABNH's financial condition arose from actions taken by ABN, ABNH's former parent, to artificially inflate ABNH's profits prior to ABNH's initial public offering. *Id.* ¶ 12. ABN caused ABNH to record revenue for sales that did not actually occur or that were incomplete at the time they were recorded, i.e., "bill and hold" sales. *Id.* ¶¶ 13, 35-36. To ensure that these sales were included in ABN's and ABNH's financial reports, Cantor and others deceived ABN's and ABNH's independent auditors with false representations and fabricated corporate records. *Id.* ¶¶ 13, 37-38. In terms of the conspiracy to violate the anti-bribery provisions of the FCPA, ABNH was informed by its foreign sales agent in Saudi Arabia that he needed additional funds to pay "consultancy fees" in connection with ABNH's bid to print holographs to be applied to Saudi currency. *Id.* ¶ 46. Cantor believed that a portion of the fees would be paid to Saudi officials. *Id.* ¶ 47. After ABNH's bid was approved by the Saudi Arabia Monetary Agency, Cantor approved the transfer of $239,000 to a Swiss bank account for the "consultancy fee." *Id.* ¶¶ 49-50. Cantor pled guilty to all four counts. Sec. & Exch. Comm'n v. Weissman, Civil Action No. 01 CV 6449, Litigation Release No. 17,068A (S.D.N.Y. July 18, 2001), *available at* http://www.sec.gov/litigation/litreleases/lr17068a.htm. The SEC filed related complaints and administrative actions involving securities fraud and violations of the anti-bribery and

keeping provisions to be charged in conjunction with a violation of the anti-bribery provisions or in conjunction with other violations of U.S. law.[150] The record-keeping provisions can and do play a critical role in buttressing charges of violations of statutes other than the anti-bribery provisions. They are particularly used to compliment charges involving accounting and other forms of financial fraud.[151] While the record-keeping provisions have

---

accounting and record-keeping provisions of the FCPA with respect to Cantor, ABN, ABNH, and others. *Id.*

[150] In *United States v. Rothrock*, Daniel Ray Rothrock, an officer of the Cooper Division of Allied Products Corporation ("Allied"), an issuer, pled guilty to a single count of violating the record-keeping provisions for preparing a "bogus" invoice in the amount of $300,000. Plea Agreement, United States v. Rothrock, No. SA01CR3430G (W.D.Tex. June 13, 2001), *reprinted in* 3 BUSINESS LAWS, INC. (FCPA) 699.818801. In 1991, the Cooper Division entered into a contract to sell work over rigs to RVO Zarubezhneftestroy ("Nestro"), a government-owned purchasing agency in Russia. *Id.* At that same time, an agreement was reached to pay a sales commission of $282,076 to Trading & Business Services, Ltd. ("TBS"), an entity jointly-owned by Comco Holding, A.G. ("Comco"), a Swiss company, and Nestro. *Id.* This payment was for the ultimate benefit of Nestro. *Id.* A day after the sales commission was paid, the Cooper Division obtained the rig contract from Nestro. *Id.* Knowing that no consultation fee or market study had been or would be provided by TBS, Rothrock later delivered to TBS a draft of a $300,000 invoice for a "consultation fee and market study." *Id.* The draft invoice was in reality a mechanism for disbursing Allied funds to TBS. *Id.* Rothrock received an invoice similar to the draft invoice from an Austrian company with which the Cooper Division had no contract or relationship. *Id.* Following the signing of the second contract with Nestro for additional rigs, Rothrock, using the bogus invoice from the Austrian company, had the Cooper Division issue a check to the Austrian company for $300,000. *Id.* It was in reality an invoice from TBS. *Id.* While the circumstances suggested a possible violation of the anti-bribery provisions, the record-keeping provisions was ultimately used as the mechanism to address the questionable series of events.

[151] In *United States v. Königseder*, a European sales executive of Informix was charged with making materially false and misleading statements to Informix's auditors in violation of Rule 13b2-2, falsifying books and records in violation of Rule 13b1-2, and wire fraud in violation of 18 U.S.C. § 1343 (2000). Indictment ¶¶ 25-29, United States v. Königseder, Cr. 00-0517 (N.D. Cal. Oct. 5. 2000). The misstatements to Informix's auditors took place in the course of Informix's efforts to determine the scope of its restatement of earnings. *Id.* ¶¶ 18-22. Königseder was alleged to have approved a number of "sham" sales transactions in 1996 in order to meet financial targets, including approving and ratifying secret side letter agreements in connection with software sales contracts that made revenue recognition on those contracts improper. *Id.* ¶¶ 15-17. He also approved and signed purported "sales contracts" that mischaracterized the underlying transactions so that the Informix could record revenue, even though no sales were taking place. *Id.*

In *United States v. Bergonzi,* in connection with a financial accounting fraud at McKessonHBOC, the accounting and record-keeping provisions were used as the basis for criminal charges. Superseding Indictment, United States v. Bergonzi, No. CR 00-0505 MJJ (N.D. Cal. Jan. 12, 2001). The company was formed in 1999 by the merger of McKesson Corp. and HBO & Company ("HBOC"). *Id.* ¶ 3. The superseding indictment against the former co-presidents and co-chief operating officers of HBOC alleged that, prior to the

been used primarily in the context of situations when material misstatements or omissions in financial statements are involved,[152] no such requirements exist in order to charge a violation of the record-keeping provisions.[153]

Especially when records are falsified so as to conceal a violation of statutes other than the anti-bribery provisions, the record-keeping provisions can and do play a strategic role in being among the charges brought. The record-keeping provisions have been used in conjunction with allegations of violations by defense contractors,[154] of public corruption within the United States,[155] kickbacks,[156] concealing an off-the-books account,[157] and commercial bribery.[158]

---

merger, HBOC management systematically defrauded HBOC shareholders and the investing public by fraudulently inflating HBOC's financial results. *Id.* ¶¶ 11-14.

Millions of dollars in revenue were generated by contracts that had side-letter and recourse agreements that were withheld from the company and concealed from the outside auditors. *Id. passim.* Fraudulent entries were recorded and misstatements were made to auditors in order to conceal the scheme. *Id. passim.* In addition to, among others, securities fraud and mail and wire fraud, 15 U.S.C. § 78j(b); 18 U.S.C. §§ 1341, 1343, this series of events served as the basis for alleging violations of Rule 13b2-2 for false representations to the auditors, of Rule 13b2-1 for record-keeping violations, and of the internal accounting controls provisions of the FCPA, 15 U.S.C. § 78m(b)(2)(B). *Id. passim.*

[152] *See* Zarin, *supra* note 50, at 3-7.

[153] Increasingly, enforcement actions in a criminal context are taken in the absence of material misstatements or omissions in financial statements. *Cf., e.g., supra* notes 153-54; *infra* notes 157-61.

[154] The record-keeping provisions came into play in *United States v. UNC/Lear Services, Inc.* ("UNC"), where military parts and services were supplied to Saudi Arabia by UNC on a foreign military sales contract awarded by the U.S. government. Statement of Facts ¶¶ 1-2, United States v. UNC/Lear Services, No. 3:00-cr-00031 (W.D. Ky. Dec. 8, 1999), *reprinted in* 2 BUSINESS LAWS, INC. (FCPA) 600.050. A Kentucky firm served as UNC's subcontractor and a Saudi consulting firm acted as UNC's and the subcontractor's agent in Saudi Arabia. *Id.* ¶¶ 3, 5. The subcontractor enlisted the aid of UNC's contract manager to create the appearance of a competition to meet procurement regulations, thereby enabling the subcontractor to inflate the cost of the parts. *Id.* ¶¶ 9-14. In addition, the contract included a "handling fee" to cover UNC's costs associated with the performance of the contract. *Id.* ¶ 4. Contrary to UNC's representations as to it not having any agents working on the contract, the subcontractor sent fictitious invoices to UNC for "in country engineering services" to secure payments for the Saudi consultant. *Id.* ¶ 8. UNC violated the record-keeping provisions by falsely recording the payments as fees for engineering services. Information, Count Three, United States v. UNC/Lear Services, No. 3:00-cr-00031 (W.D. Ky. Dec. 8, 1999), *reprinted in* 2 BUSINESS LAWS, INC. (FCPA) 600.053. In addition to the record-keeping violations, UNC pleaded guilty to mail fraud and to submitting false statements to the U.S. government. Plea Agreement ¶ 2, United States v. UNC/Lear Services, No. 3:00-cr-00031 (W.D. Ky. Dec. 8, 1999), *reprinted in* 2 BUSINESS LAWS, INC. (FCPA) § 600.053.

[155] In *United States v. Crop Growers Corp.*, the record-keeping provisions were used to support charges of public corruption within the United States. 954 F. Supp. 335 (D.D.C. 1997). As an outgrowth of the investigation of former Secretary of Agriculture Michael

Espy, the Independent Counsel charged a U.S. issuer, Crop Growers Corp., and two of its officials with a scheme to violate the Federal Election Campaign Act. *Id.* at 340. To conceal the improper contributions, among the charges were alleged violations of the record-keeping provisions for making and keeping false books and records, for falsifying accounting records, for making false statements to auditors, and for failing to disclose material facts to auditors. *Id.* at 340, 352.

The charges relative to violating the record-keeping provisions were dismissed due to the absence of proper venue. *Id.* at 352-54. The act of falsifying the records took place outside the state and district in which the charges were brought. *Id.* Ironically, the options for venue are greater for crimes committed outside of the United States. *See* 18 U.S.C. § 3238 (2000).

[156] In *United States v. Scharf*, as part of a kickback scheme, Scharf, an officer of an issuer arranged with a sales representative to pay inflated sales commissions in exchange for receiving as a kickback substantial portion of the commissions. Information, United States v. Scharf, No. Cr-84-76 (N.D. Ohio 1984), *reprinted in* 3 BUSINESS LAWS, INC. (FCPA) 696.72. He pled guilty to mail fraud, tax evasion, and to violating Rule 13b2-2 for making a false statement to auditors. Daily Report, Dep't of Justice, Criminal Div., Fraud Section, D.J. No. 113-57-37, *reprinted in* 3 BUSINESS LAWS, INC. (FCPA) 696.72. He stated in writing that the "[c]ompany is not aware of any transactions which could be considered a violation of SEC Rule 13B-2 [which] . . . rule relates to . . . the question of illegal corporate payments and practices." Information, Part D, ¶ 2.

[157] In *United States v. Duquette*, Numex Corporation, an issuer, maintained a bank account which was not reflected in its books and records. Information, Part IV, ¶ 16, United States v. Duquette, No. H-84-64 (D. Conn. 1984), *reprinted in* 3 BUSINESS LAWS, INC. (FCPA) 696.74. Numex used the account to divert payments it had pledged to a commercial lender as collateral for a financing loan. *Id.* Officers of Numex disguised the diversion of monies by recording false entries in Numex's books and by altering photocopies of customer invoices and checks which were provided to the lender. *Id.* ¶ 17. When Numex's accountants discovered the off-the-books account, the officers prepared bank statements for the accountants which failed to reflect most of the transactions in the account. *Id.* ¶ 19. When the accountants tried to confirm the information contained in the false bank statements, the defendants intercepted the confirmation and caused one of their employees to falsify the information contained in the confirmation form and forge the signature of a bank official. *Id.* ¶ 21. The officers later presented the falsified bank statements and other corporate records to the SEC. *Id.* ¶ 24. The objects of the conspiracy included a securities law violation, record-keeping violations, and obstruction of justice. *Id.* Part II.

[158] In *United States v. Thomson,* the charges stemmed from the participation by officers of HealthSouth in a scheme to bribe the director general of a Saudi Arabian foundation to secure an agreement to provide staffing and management services for a 450-bed hospital in Saudi Arabia. Indictment ¶¶ 6-7, United States v. Thomson, No. CR-04-J-0240-S (N.D.Ala., July 28, 2004), *reprinted in* 3 BUSINESS LAWS, INC. (FCPA) 699.907400. The director general solicited a $1 million payment from HealthSouth, ostensibly as a "finder's fee." *Id.* ¶ 9. Against the advice of counsel, *id.* ¶ 10, the officer agreed to pay the director general $500,000 per year for five years in return for his agreement to execute the contract on behalf of the Saudi Arabian foundation. *Id.* ¶ 12 (Count 1). To facilitate the arrangement, officers arranged for the director general to execute a sham consulting contract with a HealthSouth-affiliated entity in Australia. *Id.* ¶¶ 15-16 (Count 1). A conspiracy was alleged, *id.* Count 1, in addition to violations of the Travel Act by using the facilities of interstate commerce to promote unlawful activity, namely commercial bribery in violation of Alabama law, *id.* Count 2, and of the FCPA's record-keeping provisions by causing HealthSouth's books,

In contrast, the accounting provisions are rarely used in the context of criminal proceedings. What constitutes adequate internal controls is, by nature, a very esoteric determination. It can be subject to a myriad of interpretations that would be confusing to lay persons and even to persons of considerable expertise.[159] The result is that, except for the most egregious situations, violations of the accounting provisions relating to internal controls are not likely to be charged.

B. CIVIL ACTIONS

The standard of proof in a civil enforcement action is a preponderance of evidence as opposed to the reasonable doubt standard applicable in a criminal enforcement context. This distinction represents a substantial reduction in the nature and quantum of evidence required to establish a violation of the accounting and record-keeping provisions. Of even greater significance is the absence of scienter for civil liability. But the penalties and sanctions associated with a civil violation are considerably less than when there is a criminal conviction.

While countless actions were brought over the years under the accounting and recording-keeping provisions in contexts in which the bribery of foreign officials was not involved, the SEC demonstrated little interest in the anti-bribery provisions of the FCPA and brought few such actions.[160] Almost all of the enforcement activity resided with the Department of Justice.[161] However, in recent years, the SEC has signaled a renewed interest in focusing its investigatory efforts on the anti-bribery provisions of the FCPA.[162]

---

records and accounts to falsely and fraudulently reflect that the payments made to fund the sham consulting contract were made for legitimate purposes. *Id.* (Counts 3 and 4).

[159] *See* Sec. & Exch. Comm'n v. World-Wide Coin Inv., Ltd., 567 F. Supp. 724, 751 (N.D. Ga. 1983) ("The main problem with the internal accounting controls provision of the FCPA is that there are no specific standards by which to evaluate the sufficiency of controls; any evaluation is inevitably a highly subjective process in which knowledgeable individuals can arrive at totally different conclusions.").

[160] *See, e.g.*, DEMING, *supra* note 3, at 41; Matthews, *supra* note 11, at 305.

[161] DEMING, *supra* note 3, at 41.

[162] The renewed interest was first evidenced in *Sec. & Exch. Comm'n. v. Triton Energy Corp.*, where the SEC filed a civil injunctive action against Triton Energy as well as senior officers of Triton Indonesia, Inc. ("Triton Indonesia"), a subsidiary of Triton Energy. Litigation Release, No. 15,266 (Feb. 27, 1997), *available at* http://www.sec.gov/litigation/litreleases/lr15266.txt. The officers authorized improper payments to an agent of Triton Indonesia who was acting as an intermediary with Indonesian government agencies.The payments were made despite "knowing or recklessly disregarding the high probability" that the payments would be passed along to Indonesian government employees for the purpose of influencing their decisions affecting the business of Triton Indonesia." *Id.* The payments

Yet, in almost every case where an issuer was involved, the accounting and record-keeping provisions served as the critical link in addressing the underlying bribery that is alleged to have taken place.[163] The provisions have even been employed in situations where a foreign issuer has engaged in bribery within its own country.[164] Ultimately, whether an action is

---

were falsely recorded as routine business expenditures. *Id.* While Triton Energy did not expressly authorize or direct the improper payments and "misbookings," it was alleged to have failed to maintain an adequate system of internal accounting controls to detect and prevent the improper payments. *Id.* In a related administrative proceeding, *In re* David Gore, Robert Puetz, William McClure, and Robert P. Murphy, senior officers of Triton Energy were found to have caused Triton Energy to violate the anti-bribery and record-keeping provisions for failing to take action after learning of potentially unlawful conduct. Exchange Act Release No. 383,343, Administrative Proceeding File No. 3-9262 (Feb. 27, 1997), *reprinted in* BUSINESS LAWS, INC. (FCPA) § 699.470.

[163] A cease-and-desist order was entered in *In re Chiquita Brands International, Inc.*, for Chiquita's violations of the accounting and record-keeping provisions in connection with a payment to foreign customs officials by Banadex, Chiquita's wholly-owned Columbian subsidiary. Administrative Proceeding, File No. 3-10613, Accounting and Auditing Enforcement Release No. 1463 (Oct. 3, 2001), *available at* http://www.sec.gov/litigation/admin/34-44902.htm. Banadex employees authorized payments of approximately $30,000 to local customs officials to secure renewal of a license at Banadex's port facility in Columbia. *Id.* One payment was incorrectly identified as a maritime donation, and the other was incorrectly identified as relating to a maritime agreement. *Id.* Even though the payments were made without the knowledge or consent of Chiquita officials outside of Columbia and even though the payments were made in violation of Chiquita's strict policies, Chiquita was found responsible for ensuring that its wholly-owned foreign subsidiaries complied with the accounting and record-keeping provisions. *Id.* Through Banadex's employees, Chiquita violated the record-keeping provisions by maintaining books and records that inaccurately reflected Banadex's transactions and disposition of assets. *Id.* Chiquita violated the internal control provisions by failing to maintain a system of internal accounting controls to ensure that Banadex's books and records accurately and fairly reflected the disposition of its assets. *Id.* A critical factor in the action taken by the SEC was Chiquita's failure to take remedial action after its "internal auditing staff made management aware of a number of instances in which Banadex had not provided documentation required by Chiquita's internal accounting control procedures regarding discretionary expenses." *Id.*

[164] In *Sec. & Exch. Comm'n. v. Montedison, S.p.A.*, an Italian firm was involved with the bribing of Italian politicians. Litigation Release No. 15,164 (Nov. 21, 1996), *available at* http://www.sec.gov/litigation/litreleases/lr15164.txt. However, the SEC did not have a jurisdictional basis to pursue violations of the anti-bribery provisions since there were no "fund or instructions" emanating from the United States. Matthews, *supra* note 11, at 324. Yet, since Montedison had ADRs listed on the New York Stock Exchange, the SEC had jurisdiction to file suit under the jurisdiction under the Exchange Act. Montedison was charged with defrauding the investing public by misstating its financial condition and results of operations in periodic reports filed with the SEC by concealing hundreds of millions of dollars of payments that, among other things, were used to bribe politicians in Italy. Sec. & Exch. Comm'n. v. Montedison, S.p.A., Litigation Release No. 16,498 (Mar. 30, 2001), *available at* http://www.sec.gov/litigation/litreleases/lr16948.htm; Litigation Release No.

brought by the SEC will rest largely upon the nature and severity of the underlying conduct that is concealed by inadequate internal controls or inaccurate records. As is the case in a criminal context, an SEC enforcement action for a violation of the accounting and record-keeping provisions does require that it be brought where there are allegations of major financial fraud.[165]

The internal controls provisions provide an almost endless series of bases for the SEC to take action against an issuer.[166] This is particularly so

---

15,164. Its controls were so deficient that no one was able to reconstruct precisely what occurred and who was responsible. Release No. 15,164. Among the charges were allegations of violating the internal control provisions and creating and maintaining false books and records. *Id.* Its "accounting policy did not require that any documentation be submitted to support the disbursement of corporate funds." *Id.* A settlement was ultimately reached in 2001 when Montedison paid a civil penalty of $300,000. Release No. 16,948.

[165] In *United States v. KPMG-Siddharta Siddharta & Harsono,* for the first time the Department of Justice and the SEC filed a joint injunctive action against KPMG-Siddharta Siddharta & Harsono ("KPMG-SSH"), a public accounting firm in Indonesia and Sonny Harsono, a partner with KPMG-SSH, which is an affiliate of KPMG International. Litigation Release No. 17,127 (Sept. 12, 2001), *available at* http://www.sec.gov/litigation/litreleases/lr17127.htm. To reduce a tax assessment, Harsono authorized the payment of a bribe by KPMG-SSH to an Indonesian tax official for one of KPMG-SSH's clients, an Indonesia client owned by Baker Hughes, PT Eastman Christensen ("PTEC"). *Id.* The authorization was conditioned upon the direct approval of Baker Hughes. *Id.* To conceal the improper payment, Harsono had KPMG-SSH prepare a false invoice for services that were not rendered. *Id.* PTEC paid the invoice and thereby entered the transaction on its books and records as a payment for professional services. *Id.* A civil injunctive action was also filed against the CFO and controller of Baker Hughes for authorizing the payment of a $75,000 bribe through KPMG-SSH in violation of the anti-bribery and accounting and record-keeping provisions. *Id.* The CFO and controller were alleged to have directed the payment to KPMG-SSH. *Id.* In addition to finding that Baker Hughes had authorized the improper payment by KPMG-SSH in the accompanying administrative proceeding against Baker Hughes, it was also found that senior managers of Baker Hughes authorized payments to its agents in India and Brazil without making adequate inquiry as to whether portions of the payments were being given to foreign officials. *In re* Baker Hughes Inc., Exchange Act Release No. 44784 (Sept. 12, 2001), *available at* http://www.sec.gov/litigation/admin/34-44784.htm. With respect to the latter payments, there was also a finding that Baker Hughes did not fairly and accurately record the payments. *Id.*; *see also supra* notes 57, 84, 162-65 and *infra* note 168.

[166] Stuart H. Deming, *The Foreign Corrupt Practices Act: The Accounting and Record-Keeping Provisions, in* THE FOREIGN CORRUPT PRACTICES ACT AND OECD CONVENTION: MITIGATING AND MANAGING RISKS IN THE CHANGING LEGAL ENVIRONMENT B-7 (ABA-CLE 2001) (citing Paul V. Gerlach, Associate Dir., Div. of Enforcement, Sec. and Exch. Comm'n, Remarks at the ABA's National Institutes on the Foreign Corrupt Practices Act (Feb. 19, 1999 and March 12, 1999)). As an example, in *Sec. & Exch. Comm'n. v. Titan,* among the allegations in the complaint against Titan, the SEC alleged that Titan failed to devise or maintain an effective system of internal controls to prevent or detect FCPA violations. Litigation Release No. 19,107 (Mar. 1, 2005), *available at* http://www.sec.gov/litigation/litreleases/lr19107.htm.

in the context of civil enforcement where, as opposed to criminal enforcement, proof of intent is not required. The FCPA and especially its internal control provisions will always be applied in hindsight.[167] In such situations, the internal controls will rarely be found to be adequate.[168]

VII. IMPLICATIONS OF THE ACCOUNTING AND RECORD-KEEPING PROVISIONS

Any analysis of the FCPA must bear in mind that its provisions have rarely been subject to judicial scrutiny.[169] Though the FCPA has had, and will increasingly have, a major impact on how business is conducted, relatively few prosecutions have been brought under the anti-bribery provisions. Of these, most have resulted in the entry of a guilty plea or some sort of civil settlement.[170] While far more prosecutions have been

---

> Despite utilizing over 120 agents and consultants in over sixty counties, Titan never had a formal company-wide FCPA policy, failed to implement an FCPA compliance program, disregarded or circumvented the limited FCPA policies and procedures in effect, failed to maintain sufficient due diligence files on its foreign agents, and failed to have meaningful oversight over its foreign agents.

Id.

[167] DONALD R. CRUVER, COMPLYING WITH THE FOREIGN CORRUPT PRACTICES ACT: A GUIDE FOR U.S. FIRMS DOING BUSINESS IN THE INTERNATIONAL MARKET PLACE 29 (2d ed. 1999).

[168] One such rare exception involved a cease-and-desist proceeding in 2000 with International Business Machines Corporation ("IBM") and its wholly-owned subsidiary in Argentina, IBM-Argentina, S.A. ("IBM-Argentina"). Sec. & Exch. Comm'n v. Int'l Bus. Mach., Litigation Release No. 16,839 (Dec. 21, 2000), *available at* http://www.sec.gov/litigation/litreleases/lr16839.htm. The enforcement action was premised upon violations of the books and records provisions of the FCPA for "presumed illicit payments to foreign officials." *Id.* No violations of the internal control provisions were alleged. *See id.* In connection with a $250 million contract to modernize the computer system of a commercial bank owned by the Argentine government, IBM-Argentina entered into a $22 million subcontract with an Argentine subcontractor which, in turn, was alleged to have passed on $4.5 million to officials of the Argentine bank. *Id.* The order, issued in the accompanying administrative proceeding, found that IBM-Argentina's management "overrode IBM's procurement and contracting procedures"; "hid the details of the subcontract" from the technical and financial review personnel assigned to the contract; and "fabricated documentation, including a backdated authorization letter and a document that stated incomplete and inaccurate reasons for hiring [the subcontractor]." *In re* Int'l Bus. Mach. Corp., Exchange Act Release No. 43,761 (Dec. 21, 2000), *available at* http://www.sec.gov/litigation/admin/34-43761.htm. IBM-Argentina recorded the payments as third-party subcontractor expenses which were, in turn, incorporated into IBM's 1994 Form 10-K. *Id.* The order further noted that IBM's policies and procedures had been circumvented and that no employee of IBM in the United States was aware of what had transpired. *Id.*

[169] *See* DEMING, *supra* note 3, at 6.

[170] *Id.*

brought under the accounting and record-keeping provisions, most have been in the context of civil proceedings initiated by the SEC and, even in that context, the vast majority of cases have resulted in settlements.[171]

A multitude of legal issues associated with the FCPA have accordingly not been subject to judicial review. The anticipated upsurge in prosecutions can be expected to lead to rather extensive litigation at both the trial and appellate levels.[172] While entities are generally not inclined to contest enforcement actions, this will not be the case with individuals subject to long terms of imprisonment.[173] Increasingly, incarceration is more likely and more severe for white-collar crime.[174] "As a result, the basic underpinnings of the FCPA, as well as the application of its provisions, will be subject to more and more challenges with the anticipated increase in criminal prosecutions."[175]

Situations are likely to arise where courts will interpret the FCPA differently from how it has been applied by the Department of Justice and the SEC.[176] However, until the countours of the accounting and record-keeping provisions are more clearly defined, the prudent approach in providing guidance to clients is to rely on historical interpretations as applied by U.S. enforcement officials.[177] The advice provided should be designed to deter conduct that is apt to serve as a basis for an

---

[171] *See* 2 BUSINESS LAWS, INC. (FCPA) 260.001-260.211.

[172] Among the factors prompting the anticipated upsurge in prosecutions includes the continuation of the renewed interest on the part of the SEC in enforcing the anti-bribery provisions as well as the added impetus given to enforcement of the accounting and record-keeping provisions by Sarbanes-Oxley. In addition, provisions in each of the anti-bribery conventions relating to cooperation and exchange of information will increasingly remove obstacles to obtaining evidence in foreign settings. OECD Anti-Bribery Convention, *supra* note 2, art. 9; Inter-American Convention Against Corruption, art. XIV; CoE Criminal Law Convention, *supra* note 2, arts. 25-26; U.N. Convention, *supra* note 2, arts. 43, 46, 48-50.

[173] *See* DEMING, *supra* note 3, at 6.

[174] While the Supreme Court in *United States v. Booker* eliminated the mandatory nature of the U.S. Sentencing Guidelines, they will continue to be treated as advisory by federal courts in the United States. 543 U.S. 220 (2005). Sarbanes-Oxley also proposed the enhancement of the sentencing guidelines for white-collar crime. Sarbanes-Oxley, *supra* note 31, §§ 805, 905, 1104; 116 Stat. at 802, 805-806, 808-809. The U.S. Sentencing Commission subsequently recommended a series of enhancements. U.S. SENTENCING COMM., INCREASED PENALTIES UNDER THE SARBANES-OXLEY ACT OF 2002, at 1-15 (Jan. 2003) (report to 108th Congress), *available at* http://www.ussc.gov/r_congress/S-Oreport.pdf.

[175] DEMING, *supra* note 3, at 6.

[176] *Id.*

[177] *Id.*

investigation.[178] "If an investigation arises, and charges are brought, a host of legal issues can still be legitimately raised."[179]

Over time the accounting and record-keeping provisions can be expected to become a staple in the charges brought by federal prosecutors to address a wide range of conduct associated with white collar crime. They provide an incredibly potent tool in a prosecutor's arsenal. A truly effective compliance program must therefore include proper record-keeping and adequate internal controls.[180] The manner in which the accounting and record-keeping provisions were intended to operate in tandem with the anti-bribery provisions, and other statutes, must always be kept in mind in designing, implementing, and monitoring a compliance program.

---

[178] *Id.*

[179] *Id.*

[180] Even for entities that are not issuers, a compliance program must ensure that records are accurately recorded and that the internal controls are effective. Charges like those associated with assisting in the filing of a false tax return in *Titan* demonstrate how inadequate internal controls and accurate records can expose entities not subject to the accounting and record-keeping provisions to serious criminal charges. Sec. & Exch. Comm'n. v. Titan, Litigation Release No. 19,107 (Mar. 1, 2005), *available at* http://www.sec.gov/litigation/litreleases/lr19107.htm.