

2016

## Accounting, the cost of corruption and abuse of power in the United States (1970-1990): lessons to be learned

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# Accounting, the Cost of Corruption and Abuse of Power in the United States (1970-1990): Lessons to be Learned

A thesis submitted in fulfilment of the requirements for the award of the Degree

**DOCTOR OF PHILOSOPHY**

From

**UNIVERSITY OF WOLLONGONG**

By

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**SCHOOL OF ACCOUNTING, ECONOMICS & FINANCE**

**FACULTY OF BUSINESS AUSTRALIA**

**2016**

**Supervisors:** Associate Professor Kathie Cooper and Emeritus Professor Michael Gaffikin

# Abstract

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The Watergate scandal and resulting resignation of President Richard Nixon in the early 1970s, is arguably the most egregious instance of corruption at the highest levels of government in the history of the United States (U.S). The scandal revealed a disturbing pattern of misuse of corporate funds for improper or illegal purposes by U.S companies, domestically and internationally. A series of hearings in response to these issues, made it apparent that legislation was required to address corrupt activities. The hearings also shed light on discoveries of cases of financial misstatements that were not discovered or reported by auditors and boards of directors. The role of accounting, auditors and accountability in disguising the corrupt and bribery payments were not the main concern of the hearings and inquiries. Even through, bribes and questionable payments had become the norm of business practices. It was apparent that the accountability system, that is designed to assure the proper accounting of the use of corporate funds, was frustrated.

The United States became the global leader in the fight against corruption in international business with the passage of the Foreign Corrupt Practices Act (FCPA) in 1977 as the first legislation in the world to recognise and seek to curb the contribution of domestically based corporations to foreign corruption. The act included accounting provisions relating to record keeping requirements and establishment of a system of controls for the perceived assurance of corporate accountability. However, the FCPA did little to address the accounting and auditing failures that were initially raised by the Congress or the Securities and Exchange Commission (SEC). The act would have been significant if it had the ability to affect the governance and accountability mechanisms

of corporations, the work of independent auditors and the role of the Securities and Exchange Commission.

However, the enactment of the FCPA became largely a symbolic exercise and was “referred to by some commentators as a legal sleeping dog” (Giudice 2011, p.351). From its inception, the proposed bills by Senators and Congressman reflected “a cautious approach to this immense problem” (United States 1977d, p.28), which led to “a more loose, flexible framework for disclosure... than lay[ing] down detailed, mandatory guidelines” (United States 1977d, p.29). The FCPA was not enforced vigorously by the two bodies in charge, namely the SEC and the Department of Justice. The number of cases that went to trial under the act were low and mainly resulted in minimal penalties. The enforcement was indirectly affected by the U.S. President of the time and their political agenda, which affected the amount of funding and resources available to the bodies in charge. Due to ineffectiveness of the FCPA in changing corporations’ governance system and accountability to their stakeholders, and lack of enforcement, during 2002 the Sarbanes-Oxley (SOX) act was enacted to address these post-Watergate accounting and auditing issues.

# Acknowledgement

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Firstly, I would like to express my sincere gratitude and appreciation to both of my supervisors, Associate Professor Kathie Cooper and Professor Michael Gaffikin for their continuous moral support and invaluable guidance and suggestions throughout my journey of writing my thesis. I also want to thank them for their patience, motivation, and immense knowledge in every step of the way and writing of this thesis. I am grateful for having the opportunity to grow and learn from my supervisors' knowledge, expertise and valuable feedback, and being mentored by them. I am hopeful that one day I could be as enthusiastic, supportive and knowledgeable as my supervisors and to be able to help future research students. Besides my supervisors, I would like to extend my thanks to the heads of School of Accounting, Economic and Finance and heads of Accounting discipline during my study, for their encouragement, support and providing me with the opportunity to focus on my PhD. Without their precious support it would not have been possible to complete my journey and study in time. I am also grateful to all the people I have met along the way, in conferences and colloquiums, and have contributed to the development and progress of my thesis.

My special and sincere thanks also goes to my husband, Amir Riahi, who has been my motivational force in my life and in this journey. Words cannot express how grateful I am to my husband for his understanding, precious support, patience and sacrifices that he has made while I was busy completing my thesis. I am deeply indebted for your continues and unconditional love and in believing in me and my dream.

Last but not the least, I would like to thank my family: my parents, brother and my in-laws for their prayers, love and spiritual support throughout writing this thesis and my life in general. I know that you believed in me and wanted the best for me.

Thank you to anyone that I may have forgotten. I apologize.

# Certification

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I, Hajar Roudaki, declare that this thesis, submitted in fulfilment of the requirements for the award of Doctor of Philosophy, in the Faculty of Business, University of Wollongong, is wholly my own work unless otherwise referenced or acknowledged. The document has not been submitted for qualifications at any other academic institution.

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Hajar Roudaki

25 May 2016

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# Chapter One: Where the Story of Corrupt Payments Started

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In the United States (U.S.), revelations of domestic and international bribery and illicit campaign contributions followed the politically funded break-in by five men to the Democratic Party's headquarters in the Watergate Building in Washington DC in June 1972 (Vega 2009). The Watergate scandal led to discoveries of patterns of concealed corporate political contributions for the purpose of obtaining foreign government sales and contracts as well as influencing the government's policies and/or obtaining regulatory favours (Barovick 1976; Lesser 1979a). It demonstrated the ability of corporate executives and management, and in some cases independent auditors to conceal the use of corporate funds for bribery and illicit payments from their boards of directors, shareholders and even the Securities and Exchange Commission (SEC)<sup>1</sup>. The evident problem of bribery and corruption amongst U.S. corporations, stimulated enactment of a piece of legislation, the Foreign Corrupt Practices Act (FCPA). Watergate was the catalyst in leading the political will to enactment of the FCPA (Lippitt 2013). The act "was a watershed event" (Cragg 2005, p.113) as it was the first legislation in the world aimed at curbing foreign and domestic bribery internationally and domestically. The accounting provisions of the act prohibited bribery indirectly (Sporkin 1997).

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<sup>1</sup> The SEC was established with the passage of the Securities Exchange Act of 1934 (Previts et al. 2003), "by its very nature, is a political organization. Commission members are appointed by the President of the United States"(United States 1985, Part 1, p.742).

## 1. The Study's Data Gathering

This study will primarily focus on the FCPA and the accounting provisions of the act as it “resulted in one of the most significant expansions of the securities law since the 1933 and 1934 Acts” (Kneedler & Grant 1980, p.22). It was “the most extensive application of federal law to the regulation of corporations” (Greanias & Windsor 1982, p.1). The importance of the act was not merely about disclosure of illicit payments but also criminalisation of the payments, which was aimed at demonstrating the moral stance of the Congress (Davis 2012a).

The study is descriptive, analysing the history of accounting bodies and the involvement of the SEC in setting accounting and auditing standards in the United States (U.S.), the enactment of the FCPA and the political influences on the content of the act, and the enforcement and implementation of the accounting provisions of the act (systematically describing the political influences). Investigations of foreign corrupt practices in the 1970s gave rise to “the most extensive documentation of business-government corruption ever produced in history” (Posadas 2000, p.350). It was “the culmination of almost three years of congressional interest” (Goelzer 1979, p.2). This provided an opportunity to have access to all the required information such as establishment of the FASB, and the SEC’s voluntary program in relation to questionable payments, from 1972 onwards. This study has analysed the above material using a relevant theory, Actor Network Theory (ANT), to demonstrate the events surrounding the enactment of the FCPA and understanding the past as a critical path to be informed about the present rules and guidelines, as well as addressing the future.

For this reason, mainly primary data has been used to interpret specific situations. The data is taken from the Securities and Exchange Commission (SEC) archives from <http://www.sec.gov/>, archival information from the SEC's historical website, and documents such as Hansard, bills, committee transcripts, and media releases from the United States House of Representatives and the Senate and the Hathitrust database. These collections to some extent quote the academic and/or media sources that could be used as secondary data. This information has helped to target specific materials published and released by different authors with regards to this matter. This kind of secondary data has assisted this study to attain more information pertaining to the way the Government (Congress) was making decisions and the accounting profession's behaviour in this regard.

## **2. The Purpose of this Study**

This study will critically examine the history of enactment and enforcement of the Foreign Corrupt Practices Act (FCPA) by taking account of the then social, political and economic context. The Congress passed the FCPA to address the problem that was unravelling during the 1970s in relation to national corruption and bribery scandals, which stemmed from the Watergate scandal investigations. Accordingly, the Congress proposed enactment of legislation that focused on ethics and corporate morality, since ethics had “become the motherhood issue of its time” (Guterman 2013, p.25; Surrey 1979). As Koehler demonstrates, “[t]he legislative record ... evidences that congressional motivation was sparked by a post-Watergate morality, economic perceptions, and global leadership” (2012, p.938).

The FCPA, as the proposed solution by the Congress was the first legislation to include a provision in relation to corporate governance as promotion of “managerial integrity” (Goelzer 1979, p.11) that was intended to restore public confidence in corporations. As the illicit payments were seen “as symptoms of weak corporate accountability and governance mechanisms which transcended the disclosure requirements of the securities laws” (Goelzer 1979, p.6). This history reminds the reader of the significant role of “moralism ... in shaping the original Act and its 1988 Amendments” (Davis 2012a, p.498). However, the history also reminds the reader that the lessons of the 1970s were not learned by the Congress, nor the accounting profession as the problems were still prevalent in corporations at the start of the twenty first century, due to lack of rigorous enforcement of the FCPA. Similar acts were enacted during 2000s to address allegations of financial fraud, bribery and illegal practices by American businesses. Hence, the reasons for focusing on this act are explained in the following sections.

## 2.1 Unresolved Accounting Issues

From the congressional and the SEC’s investigations, major American corporations had kept “off-the-books accounts or slush funds ... for the making of questionable payments” (Fremantle & Katz 1989, p.757; Lesser 1979a) as well as falsification of financial statements (Lesser 1979a, p.159) mainly without the knowledge of the corporations’ accountants (Sporkin 1997). As stated by Lesser, the majority of these bribery payments were “limited to certain industries, particularly the military weapons, aircraft, and oil industries” (1979a, p.160). The investigations also led to questioning the integrity and reputation of American corporations.

The accounting provisions of the FCPA were argued by the then SEC chairman, Williams, as the “more significant feature of the new act ... than the anti-bribery sections” (Williams 1979a, p.20). This is shown in the final Senate report wherein it states the purpose of the FCPA was “to strengthen the accuracy of the corporate books and records and the reliability of the audit process which constitute the foundations of ... [the] system of corporate disclosure” (U.S. Senate 1977, p.4). From the SEC’s point of view the accounting provisions were a form of self-regulation rooted in the

principles of ‘new governance’ requiring high standards of accountability grounded on the work of independent audit committees that would oversee stricter policies using enhanced systems of internal control for monitoring international business conduct (Cragg 2005, p.123).

In unravelling the wrongdoings of corporations the hearings led to what was described as “the most significant hearings ever conducted by any committee of the Congress” (United States 1973b, book 1, p.7). In spite of the apparently noble motivations of the policy makers, the accounting provisions were minimal and did not include “any new disclosure” requirements and “merely require[d] a standard of tight management control of corporate expenditure” (Lesser 1979a, p.183; Sporkin 1997; Stevenson 1976). Cragg (2005) argues, this was partly due to the fact that the SEC pressed for provisions that required corporations to assume responsibility for self-monitoring and self-policing, so as to reduce its own enforcement role. The self-regulation system was viewed by the SEC as the most effective and efficient means of achieving corporate self-restraint in the market place (Weismann 2008). This point of view was not shared among many of the Senators and Congressmen, since the root of the problem was seen to be the system itself and the ability of management in overriding the companies’ control systems. The

SEC's role and ability to take action against corporations, was mainly affected by their lack of resources and funding which were controlled by the U.S. President of the time (Cragg 2005; United States 1976l; United States 1976n). The President would appoint commission members of the SEC as a political organisation, affecting its policies and actions (United States 1985, Part 1). The Congress also did not consider the option of "requiring government auditors" instead of "Certified Public Accountants" in examining corporations' financial reports (Sporkin 1997, p.272).

## 2.2 The Role of the Accounting Profession in Formulation of the Accounting Provisions

During the congressional hearings held in relation to provisions of the FCPA, the accounting professional bodies such as the AICPA and the private-sector standard setting body (the FASB) were mainly passive. The involvement in the lack of disclosure of illicit payments of the accounting profession was evident, since the illicit payment problem was mainly related to lack of disclosure to stakeholders and lack of accountability of management, executives and independent auditors in protection of shareholders' assets. The problem at heart was mainly linked to the self-regulatory system of financial disclosure rather than criminalisation of illicit payments.

As will be detailed in the following chapters, the profession's contribution to congressional debates relating to the way corporations had accounted for illicit payments was minimal. The only body that publicly questioned the accountability of management, accountants and auditors was the SEC, as part of their voluntary disclosure program initiated in 1974. While other committees were investigating



corporations' illegal payments, the SEC had instituted civil injunction actions against some of the corporations admitting to the illicit payments. It was also cooperating with the Congress in the formation of legislation containing disclosure requirements. The AICPA members were partly present during one of the House of Representatives hearings during 1976, commenting on the accounting provisions. But their contribution to the hearings did not lead to any changes or amendments to the bills presented to the Congress.

It can be argued the striking absence of the accounting profession in the debates surrounding the accounting provisions of the act was its preoccupation with its own survival having recently “come under ... [their] first broad attack in the Congress” (Zeff 2003a, p.200). Based on the findings of this study, the cause of the lack of accounting profession involvement in the FCPA hearings was twofold. Firstly, during the 1970s, the need for replacement of the Accounting Principles Board (APB), a body in charge of establishing accounting principles became visible. The main concern was related to the private sector failure in their efforts to establish sound and effective accounting principles and standards. For this reason there were suggestions by the Government that the standard setting responsibility “be undertaken either by the Securities and Exchange Commission or by some new governmental body” (Sommer 1974, p.6).

The AICPA was consequently in fear of governmental interference and formation of legislation for accounting practices. It wanted “to keep the setting of principles and standards in the private sector ... at all cost” (cited in United States 1976b, p.105; United States 1985). The AICPA justified its desire to maintain authority over the

setting of standards and principles by citing “[a]llegations of government inefficiency and wastefulness” (United States 1976b, p.19). Hence, in 1971 it appointed a committee, chaired by Francis Wheat, to study and make recommendations for improving the methods of establishing accounting principles and standards in the private sector (United States 1976b). The Wheat study group members were mainly from large accounting firms, large corporations and academic accountants who were tied to big eight accounting firms (United States 1976b, p.119). The details of the committee’s report are explained in chapter three.

Secondly, during this time period, the profession was challenged for its lack of competence in regulating the accounting and auditing profession as well as its lack of independence in performing audit procedures and standard setting procedures (Holtzman 2004; United States 1976b; United States 1977a; Zeff 2003a). Collapses of corporations such as Westec, National Student Marketing and Penn Central during the 1960-1970s had raised concerns regarding auditors’ independence as well as “[p]ublic concern for fraud detection” (Briloff 1967; Glover & Aono 1995, p.3; Zeff 2003a). The collapses which led to questioning the “integrity of the financial statements ... raised harsh inquiries concerning the practices of the accounting profession” (Sommer 1980, p.54). So, corporate accountability and corporate governance structure was partly focused on during this time period due to these financial debacles.

Two congressional committees<sup>2</sup>, held by Congressman Moss and Senator Metcalf, in the 1970s were established to address the issues with financial reporting and the bodies in charge of setting the underlying principles. The recommendations were related to a shift of standard setting powers and authority to the SEC or a federal agency (United States 1976b; United States 1977a; Zeff 2003a) as well as a “series of behavioural reforms ... [to] improve auditing, accounting, and standard setting” (United States 1985, Part 1, p.14). Similar hearings<sup>3</sup>, held by Congressman Dingell, were undertaken ten years later with the aim of investigating similar issues as well as “examination of the institutions administering corporate financial standards” (United States 1985, Part 1, p.13). The hearings were repeated because there was sufficient signs indicating the reforms of the 1970s proved to be “useless structural changes” and business was as usual with the accounting profession and the SEC (United States 1985, Part 1, p.14).

The profession was defensive in the face of the recommendations of the initial hearings held in the 1970s. It was busy with its immediate response and proposed reforms in relation to these criticisms, in order to preserve their powers. The AICPA along with the FASB had prepared a 40 page booklet called the *Institute Responds* in which, according to Zeff, the two bodies “countered the arguments in the Metcalf staff study” (Zeff 2003a, p.201). The recommendations and findings were related to independence and integrity of the FASB and the “objectivity of its process” (American Institute of Certified Public Accountants 1977; Zeff 2003a, p.201). The reforms were mainly window dressing, to avoid enactment of any new legislation by the Congress to govern the accounting profession’s affairs and powers in setting standards. However, no new

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<sup>2</sup> The details of the two congressional committees held by Senator Metcalf and Congressman Moss, and their recommendations will be explained in chapter three.

<sup>3</sup> The details of the sixteen congressional hearings held by Senator Dingell, in the 1980s will be explained in chapter seven.

standard or guideline was proposed by the accounting profession. The FCPA accounting provisions, while debated in the Congress during the 1970s, were not modified to accommodate the relevant recommendations proposed by the above mentioned committees. It took however, until the enactment of the Sarbanes-Oxley act (SOX) to address post-Watergate accounting recommendations, as will be briefly explained in the following section.

### 2.3 The FCPA Predates the SOX Requirements

This study to note many of the accounting-related issues, has specifically focused on enactment of the FCPA. It is pertinent to note reforms proposed for inclusion in the FCPA were not legislated until “more recent legislation such as Sarbanes-Oxley and the Dodd-Frank Wall Street Reform and Consumer Protection Act” (Borgman & Datar 2012, p.1). The purposes of these acts reflected those of the FCPA, specifically, strengthening the integrity and reputation of American corporations both nationally and internationally after the negative publicity that accompanied a new wave of corporate and accounting scandals that emerged in the early twenty first century. Another purpose of the above acts was the reaction and proposed remedy of the legislators to the scandalous and immoral regulatory failures by corporations in the U.S. competitive political system.

While the FCPA was signed into law in 1977 to combat accusations of financial fraud, bribery and illegal practices by corporate America, later the SOX act was enacted to overcome the same issues. Both pieces of legislation were enacted to improve the accuracy of accounting and record-keeping of companies, since the problem was partly

due to corporations and independent auditors' lack of accountability to their stakeholders. As will be pointed out throughout this thesis, the FCPA was intended to restore corporate accountability. However, from its inception, "major U.S. corporations, manufacturers' lobbyists, and exporter groups" opposed the enactment of the act due to its claimed ill-conceived effect on corporations' operations and sales abroad (Guterman 2013, p.9). Also, the influence of successive presidents and their different political agendas and a lack of political will on the part of government agencies, insufficient resources, and monitoring and enforcement powers, resulted in the act not having the intended effect of changing corporate behaviour.

Although it was intended by some of the Senators and Congressmen to address the prevailing problems by enacting the FCPA, the problems and issues had continued to occur up until the early years of the twenty first century. During this time period, outrageous scandals such as Enron and WorldCom evolved, which prompted the legislature to acknowledge that the problems were still prevalent in corporations and that the FCPA had not been enforced rigorously. The problems as discussed during the 1970s congressional hearings as well, were mainly related to independence and the role of auditors and audit committees as gatekeepers. The enactment of the SOX act was in the hope of addressing these issues that were proposed to be included in the FCPA.

It needs to be considered that the SOX act has been used in this study to demonstrate that the problem of corruption and bribery payments were not stopped or even minimised by the enactment of the FCPA. For this reason, references to the SOX act is used in this study to demonstrate the failure of the FCPA to stop or even minimise the

problem of corporate corruption and bribery. In other words, the lessons of Watergate and subsequent revelations of bribery and corruption were not learned by the accounting profession, the SEC and the Congress in combating corporations' fraudulent activities.

## 2.4 Supply and Demand side of Corruption

The FCPA itself was only directed to the supply side of corruption: how American corporations had made illegal payments to public officials and overseas foreign corporations (Cragg 2005; Turk 2013). This put a “considerable legal and moral burden on US multinational corporations” (Cragg 2005, p.124), while the demand side “where bribery takes place” (Turk 2013, p.329), in return for political consideration, was not addressed. This was because the U.S was not in charge of moralising other nations as well as other nations' lack of interest or capacity “to rein in their corrupt officials” (Turk 2013, p.329). As the primary focus of the original act, was mainly on the supply side of corruption, “leaders in the business community were quick to point out the potential negative effects the FCPA could have on U.S. business abroad” (Lippitt 2013, p.1893-1894) and pushed for amendments of the provisions of the act. The business community demanded the act be eased and relaxed to accommodate their dealings with other nations. Consequently, the corporate lobbying pressures led to amendment of the act in 1988 as part of the Omnibus Trade and Competitiveness Act of 1988 (Turk 2013).

### 3. Theoretical Framework<sup>4</sup>

Research methodology indicates the research methods that are considered to be appropriate for gathering valid evidence (Chua 1986a; Dillard 1991). Methodology is implicated by sets of assumptions where each one has important consequences on the way knowledge about the social world is being obtained. The methodology of this study is based on a critical approach for the purpose of taking into account the political, economic and social influences on the standard setting process. This approach to a study of accounting starts from the premise that problems in accounting potentially reflect existing problems in and of society that need to be critically analysed (Cooper & Sherer 1984, p.222). Critical theory is founded on the notion that “the individual creates the world in which he lives” (Burrell & Morgan 1979, p.279). This paradigm is based on the notion that, ontologically, “the individual creates [rather than discovers] the world in which he/she lives” and the way an individual understands the social world is dependent on the way he/she views reality (Burrell & Morgan 1979; Chua 1986b; Dillard 1991). Consequently, an individual’s interpretation gives meaning to the reality which is dependent on an individuals’ unique understanding of a particular reality, and society does not exist independently of human activity (Chua 1986a; Dillard 1991; Gaffikin 2010; Gaffikin 2008).

A critical approach to accounting starts from the premise that problems in accounting potentially reflect existing problems in and of society that need to be critically analysed (Cooper & Sherer 1984, p.222). Such an approach emphasises qualitative methods and the contextual nature of the inquiry and, to a lesser extent, quantitative methods of data

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<sup>4</sup> Based on the format of this thesis, the theoretical framework is defined and explained as part of this chapter. The reason is that this study is demonstrating the shortcomings of the FCPA in a form of a story and the chapters are related to the timeline of the events that took place between the 1970s-1990s.

collection and analysis (Baker & Bettner 1997; Burrell & Morgan 1979; Chua 1986b; Dillard 1991; Miller 1994). This approach has been introduced in accounting to assist accounting researchers to understand how accounting is used as a mechanism of controlling society and organisations (Baker & Bettner 1997). Accounting is “concerned with a socially constructed world” (Gaffikin 2008, p.16; Hines 1988) and it operates in a “social, political and economic context” (Cooper & Sherer 1984, p.207). Also,

[a]ny accounting contains a representation of a specific social and political context. Not only is accounting policy essentially political in that it derives from the political struggle in society as a whole but also the outcomes of accounting policy are essentially political in that they operate for the benefit of some groups in society and to the detriment of others (Cooper & Sherer 1984, p.208).

The aim of this study is to apply a critical approach to analyse and explain the enactment and modification of the FCPA and enforcement and implementation of the act by the governing bodies in charge. The argument is that there is a need to adopt a deeper understanding of the involvement of political parties, and the accounting bodies and profession in the process of developing the FCPA from a critical perspective, as it involves an understanding of its impact on societies and organisations. Also, this perspective takes into account the political, economic and social influences on setting the details of the accounting section of the FCPA.

There are various relevant and suitable methods that could be used to appropriately address the issues raised in this study. Social theories by Marx, Weber, Foucault and Latour for example would be suitable for studying enactment and enforcement of regulation as well as power relations (Cooper & Robson 2006; Latour 1991). Actor network theory (ANT), while argued by Callon as being “everything but a theory”



(1999, p.182), is employed as the method to understand the relation of various actors in the process of construction and reconstruction of networks in reaching a consensus in formulating legislation to put an end to illicit payments. ANT is utilised to re-examine the FCPA from a different perspective. This process is concerned with establishing and expanding the network and the shift of power between the actors in a network.

ANT articulates the relationships between the actors and enrolment of new actors in the networks created during the political processes in enactment of the FCPA. Since the focus of this theory is on the assumption that no one acts alone and actors create a network to interact. The process of building and changing a network is political in nature. The theory is concerned with the influence of actors within and between networks that form and re-form (Spira 1999) by using persuasive language. However, as ANT is criticized by many scholars for its modest concepts, this study integrates ANT and a political economy approach to understand construction and reconstruction of networks from 1972 to 1988, since a political economy approach portrays the restructuring of networks and power relation changes through this time period.

Political economy, the study of political and economic relationships, is a dominant social theory in examining governmental responses to political and corporate corruption and establishment of regulation. As argued by Turpin (2011, p.10),

[p]olitical economy encompasses the full range of the social and political situation in which economic interaction takes place, especially with respect to ... law, political debate over desirable and undesirable policies.

The political economy approach to analysis of the enactment of the Foreign Corrupt Practices Act and the actors involved in the process of establishment of this new legislation is implemented and implied. Due to the fact that “[t]he regulation of economic life is where politics and economics meet; ... everything to do with regulation concerns political economy” (Moran 2010, p.215). Therefore, political economy theory is embedded in the findings and lurks in the background, although it is seldom explicitly stated.

### 3.1 Actor Network Theory (ANT)

ANT was developed in the early 1980s from Thomas Kuhn’s *The Structure of Scientific Revolutions* (Kuhn 1970) and as a contribution to the sociology of knowledge by French sociologists Michel Callon, Bruno Latour, and John Law (Sismondo 2004, p.65). However, they do not share similar views on ANT. The theory has been used to examine accounting matters by scholars such as Robson (1991), Ezzamel (1994), Chua (1995) and Spira (1999) to name a few. As it helps describe social structure as a relational effect that continuously generates and reproduces itself by actors forming alliances as well as involving other actors and non-human actors (artifacts) to strengthen such alliances. Just as Callon (1986b) used the translation model, to explain a certain situation in a case study format, the enactment and enforcement of the FCPA is explainable within the same model. Also, similar to Callon (1999, p.183), this study uses this theory since “ANT was developed to analyse situations in which it is difficult to separate humans and non-humans, and in which the actors have variable forms and competencies”.

The only assumption that ANT makes regarding actors is “that they have some interest in being involved in the change process, which may be based on their hopes and/or fears for the consequences of such change” (Emsley 2008, p.378). ANT is mainly concerned with the generation of power and operation of power in specific instances, in the network as well as the influences within and between networks which are constantly forming and re-forming (Spira 1999). Callon, as argued by Law (1986, p.16), agrees “with Foucault who warns ... power is not a property or a possession, but a strategy or something exercised, the overall effect of a set of strategies”.

Powers and orderings are contested by human and non-human actors for securing their own interests through the process that Callon called ‘*translation*’ (1986a; 1991). He defines it as “the method by which an actor enrolls others” (Callon 1986a, p.xvii) which is similar to conversion “into a scenario, carrying the signature of its author, looking for actors ready to play its roles” (Callon 1991, p.142). A translation presupposes a medium or a “material into which it is inscribed”, that is, translations are “embodied in texts, machines, body skills [which] become their support, their more or less faithful executive” (Callon 1991, p.143).

Translation refers to the process of negotiation, representation and displacement which establish relations between actors, entities and places. It involves the re-definition of phenomena, and these re-definitions are inscribed in the heterogeneous materials which act to consolidate networks. It defines and distributes the roles of actors to be able to speak for others but in their own language (Callon 1986a). Translation would consequently lead to a situation in which certain entities control others. It is intended to provide symmetrical and tolerant descriptions of a complex process as well as

explaining the way a spokesperson would be able to obtain the rights to express and represent the interest of silent actors as part of the network (Callon 1986b). Any resistance during the translation, as indicated by Law (1992), would be defeated by the strategy of a good ordering and a set of relations in durable materials. This would be effective use of different communication approaches such as writing or speech.

Callon (1986b) conceptualises the process of forming and re-forming networks in four moments by the original French labels of problematization, intersement, enrolment, and mobilization. The notion of translation emphasizes the displacements, transformations, and changes over time which occur at every stage of the four moments. The “actors struggle with one another ... [to] first determine their existence and then (if that existence is secured) define their characteristics” (Law 1986, p.15). Each moment of translation will be explained in regards to the context of this study.

### 3.1.1 Problematisation

Problematisation is the initial stage in creation of a network by the principal actor. As well as defining the nature of the problem faced by others and his/her solution to the perceived problem. For the purpose of this study, a brief history and background of each of the principal actors is explained in the following chapters. This is to provide the reader with the context and an understanding of behaviour and actions of the principal actor.

The principal actor defines identities and interests of other actors in establishing itself as indispensable to the other actors. The proposed solution would be used by the principal

actor to persuade other actors to accept it as the way forward. During this stage the primary actor tries to become an obligatory passage point to make the network indispensable and assure the vitality and success of the translation process (Callon 1986b). The obligatory passage point brings the actors together and consequently helps in minimising the threat of predators. As Callon (1986a, p.27) states, “the translation...maps out a geography of necessary points of passage for those elements who wish to continue to exist and develop” and “problematization describes a system of alliances, or associations, between entities [actors], thereby defining the identity and what they want” (Callon 1986b, p.206). As explained by Callon and Latour (1981, p.277) this moment involves translation of “other actors’ wills into a single will for which they speak” in allowing “them to act like a single will which is, however, extremely powerful because of the forces on which it can rely”.

### 3.1.2 Interressement

The above moment is not assurance of the process of translation. Accordingly the principal actor is required to persuade and recruit other actors to assume roles in the network. The principal actor implements different actions in attempting “to impose and stabilize the identity of the other actors” that it has defined through its problematisation stage (Callon 1986b, p.207-208). This process is called interressement. During this process, the principal actor locks the other actors in place “by coming between them and their alternatives” (Law 1986, p.16). Consequently, the roles of other actors are mainly about recognising the centrality of the primary actor's own role, identity and goals.

### 3.1.3 Enrolment

After interessement is successful the next moment, enrolment, occurs which is defining the roles of each of the actors as well as actors' acceptance of the established roles and the newly created network. This moment also involves the way in which the actors in the network "relate to one another in the scheme devised by the principal actor" (Law 1986, p.16). Nevertheless, "the device of interessement does not necessarily lead to alliances...to actual enrolment" (Callon 1986b, p.211). Callon (1986b, p.211) demonstrates that "no matter how constraining...convincing the argument would be, success is never assured" since each actor could choose either to submit to integration into the actor network defined or refuse the translation. During this moment the principal actors define "a set of interrelated roles" that are attributed to the other actors who are prepared to accept them (Callon 1986b, p.211). Enrolment according to Michael (1996, p.53) entails both the "capturing" of the others and the other's "yielding".

### 3.1.4 Mobilisation

The fourth and last moment of translation, mobilisation of allies, includes the actor or actors becoming representatives or spokespeople to act as a unit of force; and seeking continued support to the underlying ideas from other enrolled actors. As explained by Callon (1986b, p.216) "[t]o mobilize, as the word indicates, is to render entities mobile which were not so beforehand". The primary actor during this moment employs a set of methods, such as persuasive language, in attempting to mobilise passive network actors to action and not to betray the principal actors' interest (Callon 1986b).

When a network passes through the above four stages, “a constraining network of relationships” would be built which could “be contested at any moment” (Callon 1986b, p.218). Callon (1986b, p.219) explains this as “[t]ranslation becom[ing] treason”. So, actors of the networks can, due to foreseen or unforeseen reasons, become dissident. The principal actor can use their interessement devices to re-establish another network and also spokespersons/people. The above explained moments will be referred to throughout this study to explain the various networks created and re-created by principal actors with their political and self-interest agenda in initiating enactment and amendment of the FCPA in the U.S.

#### **4. The Study’s Format and Application of the Theory**

The study has been divided into three sections based on ANT. Section I comprises chapters two and three, defining the problem that surfaced from the initial hearings and investigations held by the Ervin Committee and the SEC. This section also includes a brief overview of the accounting profession and accounting bodies’ state during the 1970s. Based on the phases of the translation model, chapter two explains the problematisation stage and the bases on which the main networks explained in chapters four to seven were formed. Chapter three briefly demonstrates the network that was created and re-created by the accounting profession, which was separate to the main networks explained in the other chapters.

Chapters four and five are included in section II, and explain the proposed solution for the problem identified in the previous section and the formation and reformation of the main networks of this study. This study has assumed the creation and destruction of the

networks, with reference to ANT and based on the gathered information and documents. The last section, section III, demonstrates the enforcement and amendments of the FCPA demonstrating how the problem at hand was addressed by the politicians and the accounting profession. The following is a brief outline and summary of the chapters of this thesis. The outline will demonstrate the story of this study in the context of the explained theoretical framework.

#### 4.1 Chapter Two

Chapter two provides a brief historical background regarding the Watergate scandals and pressures of this political crisis, beginning in spring 1972 as well as the outcomes of the SEC voluntary program which eventually led to enactment of the FCPA. This chapter is solely devoted to the events surrounding these hearings and investigations. The chapter explains the committees that were established to investigate corporations and also President Nixon and demonstrating the urge and push for passage of legislation to fight bribery. It also demonstrates how the committee's hearings were a catalyst for the SEC to initiate their investigations. Chapter two sets the grounds for later chapters in explaining the passage of the statute as being justified as "a moralistic theory of foreign policy endorsed by the new Carter administration" (Greanias & Windsor 1982, p.3). The chapter lays the context in which Senators and Congressmen initiated establishment of actor-networks based on this anticipated solution.



## 4.2 Chapter Three

This chapter also provides a brief historical background regarding the accounting profession and the perceived reason this study assumes for its lack of involvement in the process of enactment of the FCPA. Chapter three expands on the outcomes of the study conducted by the American Institute of CPAs (AICPA) in a move to avoid government involvement in the process of forming a new standard setting body. As well as the Senate subcommittee study into “the federal government’s role in establishing accounting practices” (United States 1976b, p.iii). As far as the theory is concerned, chapters two and three both explain the events that shaped and led to the movements towards establishment of new legislation perceived by politicians to be the appropriate solution to the problem of illicit payments.

## 4.3 Chapter Four

Continuing from chapter two, chapter four explains the actor-networks that were established from 1972 as part of the congressional hearings about various foreign corporate payments. Senators Frank Church and William Proxmire were advocates and leaders in widely holding these congressional hearings and investigations. They both had created their networks based on the problem of corruption and bribery that mainly stemmed from the Ervin Committee. Beside these committees, President Ford, as the successor to Nixon, also had created a Cabinet-level Task Force to investigate questionable payments cases and formation of new legislation. This network created by Ford was to some extent to help him in running for the 1976 presidential election (Greanias & Windsor 1982). Chapter four, provides the foundation for the following

chapter in demonstrating the bills and legislation formed by these networks as the solution to the bribery payments.

#### 4.4 Chapter Five

From 1972 to 1976 various bills were presented to the Congress by the above mentioned networks that eventually led to agreement on one bill that was enacted as the FCPA. Chapter five in detail and associated with ANT, expands on the political context and influences surrounding each of the presented bills and the networks. In explaining the events that took place, the chapter details the formation, re-formation and termination of the networks.

#### 4.5 Chapter Six

Chapter six focuses solely on the bills that were presented to the Congress during 1977, when Carter was elected as the President of the U.S. The bill that was eventually signed into law, had its perceived shortcomings and strengths, which were debated in the Congress. These arguments are utilised to demonstrate the movement of the networks through the translation model and success of the Senator Proxmire network in persuading other actors to agree to his proposed bill. This chapter partly concludes the last two chapters' findings and arguments regarding the political economy circumstances surrounding the establishment of the bills. Lastly, the chapter briefly demonstrates the way the FCPA was enforced by the SEC and the Department of Justice (DoJ), the two bodies in charge of implementing the act.

## 4.6 Chapter Seven

As soon as the FCPA was enacted in 1977, it came under attack by the Administration, and lobbyists such as the corporations. The claims of vagueness, lack of clarity and the cost to businesses were argued to be the main forces behind moves by the Congress to amend the act. Chapter seven demonstrates the arguments that were made in justifying the shift towards simplification and weakening of the FCPA. On one hand, it explains the influence and persuasion of the Reagan Administration regarding the effect and restraints of the legislation on corporations' exports. On the other hand, it presents arguments by supporters of the act, such as Proxmire, refuting the claims of those seeking to dilute provisions of the act, demonstrating the increase in the U.S. export trade. The bills presented to the Congress, were mainly focused on significantly altering both the accounting and the anti-bribery provisions of the act. Eventually the act was amended in 1988 as part of the four hundred page Omnibus Trade and Competitiveness Act. The approved amendments by the Congress were a compromise in comparison to the initial proposed changes.

## 5. Editorial Note

Due to the focus of this study on United States congressional hearings and materials, there is a number of what appear to be spelling irregularities. Also, this study has used secondary documents and sources originating from different countries for direct quotation. The most notable of these irregularities is associated with words such as 'problematization'/'problematization', 'organisation/ organization, and 'behaviour'/'behavior'. The alternative way of spelling these and other words is only used in the case of a direct quote.

Throughout this study and consistent with the reports and congressional hearings, the name of the United States departments are used for example as ‘the Department of States’ or ‘State Department’ interchangeably.

# Section I

The previous two sections detail the political events that led to the formulation of legislation condemning corruption and bribery. Section III aims at demonstrating that not only was the enactment of the FCPA controversial, but so too were the enforcement.

# Chapter Two: Love of Power and the Proneness to Abuse it<sup>5</sup>

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*We must never accede to the rationale, in foreign policy or in business, that we must become as corrupt as those we come up against (Church 1985, p.101).*

Prior to the 1990s, western societies viewed corruption as largely a problem limited to under-developed countries (Nelken & Levi 1996). However, political scandals have also been witnessed in developed countries. As argued by the then Director of Military Research, Council on Economic Priorities, Adams

Questionable corporate uses of corporate funds has a long, if not honoured, history. Such payments are not new to commerce or to politics, and past efforts to control them do not seem to have ended the practice ... and have become a problem of growing concern to American business and the public with the expansion of US business overseas following World War II (United States 1977d, p.26-27).

The Watergate scandal and resulting resignation of President Richard Nixon in the early 1970s, is arguably the most egregious instance of corruption at the highest levels of government in the history of the United States (U.S). The combination of these events known as Watergate “has become a symbol for corruption in government” (Mosher 1974, p.vii). Mosher (1974, p.5) stated “Watergate was a product of a *system* which shaped and guided the behavior of its participants”. Ralph Nader argued the perceived scandal and associated epidemic of corporate crimes discovered in its wake was the first the U.S had suffered, since the 1930’s “when [the] New York Stock Exchange president

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<sup>5</sup> George Washington (United States 1973b, Book 1, p.2)

... was convicted of stock theft ... [but] escaped prosecution by fleeing abroad dressed as a woman” (United States 1976a, p.90).

As described by Senator Ervin, the scandal “was perpetrated upon America by White House and political aides whom President Nixon himself had entrusted with the management of his campaign for reelection to the Presidency” (United States 1974, p. 1097). It was considered by commentators as one of the most tragic events in the US and “a cancer growing on the Presidency” (United States 1974, p.xxiii). The scandal revealed a pattern of misusing “public responsibility and trust” to maintain the administration in office, by bending the laws to justify the means among public offices (United States 1974, p.xxiv). The Watergate case also revealed a disturbing pattern of misuse of corporate funds for improper or illegal purposes (Loomis 1980).

According to a report by the Committee on Corporate Law and Accounting

a number of United States companies or their subsidiaries had over long periods of time paid substantial bribes, or made other payments of dubious character, to officials of foreign governments (1978, p.308).

Bribes and questionable payments had become the norm and routine business practices designed to gain a competitive edge over international and also U.S. companies (United States 1977d; United States 1977g). This point was argued by Roderick Hill, the SEC chairman, in a speech during 1976:

[t]he present phenomena may present a greater crisis because it has been caused by top officers of major companies who were not stealing for personal gain but who claim that bribery has been one of the rules of the game ... necessary for American business to be competitive worldwide; and that concealment of the truth from auditors and from boards of directors is a proper means to the end of better profits (Securities and Exchange Commission 1976a, p.3-4).

Even though illicit payments were viewed as a way of life for corporations doing business overseas, the payments had a negative effect on U.S. foreign relations and interests. On one hand it would reduce foreign trade opportunities for U.S. corporations and complicate the relationships with foreign governments, “[t]he American reputation for quality, competence, and honesty is tarnished and eroded” (United States 1976i, p.68). On the other hand, it would affect the country by diminishing its “standing before the world ... [i]n ways that are intangible and cannot be exactly measured”, and making the country “less influential and significant nation” (United States 1976i, p.68).

In this regard, in the early 1970s corruption became an issue of international concern as a direct result of political events in the United States. The Watergate investigations generated a high level of public awareness regarding the questionable conduct of some of the nation’s political and business elite. Watergate led to other investigations into the role of major U.S corporations in financing domestic political campaigns (Posadas 2000, p.351). Multinational companies had not only contributed illegally to U.S. political campaigns but had also actively channelled resources to foreign governments and foreign political parties (Posadas 2000, p.349). The bribe payments in some instances were made by U.S. companies to compete with other U.S. companies for the same business (United States 1977d). Because of the magnitude of the problem, the hearings were opened to the public and produced the most extensive documentation of corruption by business-government in history (Stevenson & Wagoner 2011).

Findings of the Watergate-related investigations demonstrate the argument of Bargh and Alvarez (2001, p.43) that individuals who use their official power for their own personal



gain and goals, do so at substantial cost to “the aims and purposes of the organization” as well as society. The scandal also demonstrates the negative impact of corruption on the reputation of a country and its political system as well as on corporations implicated in such corruption. The Congressional Research Service (CRS) report to the Congress identified the adverse effect of these scandals on the image of American democracy abroad, and American foreign policy (Seitzinger 1999).

At a general level, Tanzi (1998) and Nichols (1997) have argued respectively that corruption reduces public revenue and increases public spending by diverting resources from their most efficient uses as well as distorting the process of decision making. The resources and peoples’ talents would be shifted from productive purposes to corrupt practices, while corrupt investors would lower the quality and quantity of investments made in the country. It seems that no country can afford to sustain the social, political, or economic costs that corruption entails (Dye 2007, p.304).

## **1. Watergate Scandal**

The illicit payments came to light following the investigations of the break-ins<sup>6</sup> at the Democratic Party headquarters in the Watergate offices in Washington. The break-ins were part of the activities of President Nixon’s Re-election Committee known as the “dirty tricks department”<sup>7</sup> to discredit and weaken Nixon’s political opponents (See for example, United States 1973b, Book 10, Book 11). Major details of the Watergate

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<sup>6</sup> The purpose of break-ins was to install telephone tapping devices in the Watergate offices. The major officials in charge of the break-ins were former CIA and FBI agents.

<sup>7</sup> The details of this department are beyond the scope of this study. For further information refer to House of Representative hearings in relation to House Resolution 803 or Senate hearings held in relation to Presidential campaign activities of 1972.

break-ins and cover-up of unlawful and improper Presidential campaign funding during President Nixon's election campaign in 1972, were exposed by the Senate Select Committee on Presidential Campaign Activities. The committee hearings were seen to be more effective than "the criminal procedures of the courts in exposing, and thereby protecting the public from, unethical behaviour" due to the investigative power of Congress (Mosher 1974, p.123). The public hearings were referred to as Watergate Hearings. The Senate Select Committee, known as the Ervin Committee or Watergate Committee by the media, revealed various instances of manipulation of financial statements and diverse corruption by executives and CEO's of corporations.

Senator Gurne (United States 1973b, Book 1, p.7) during his opening statement at the initial hearing stated "[t]his committee begins today history hearings which may well turn out to be the most significant hearings ever conducted by any committee of the Congress". The committee was established in 1973 to inform the public of the full extent of the truth and wrongdoings by performing "a complete investigation and study ... and determine whether new legislation" was required (United States 1974, p.v) "to prevent future occurrences of such activities" (United States 1973b, Book 1, p.8). The investigations for establishment of new legislation set the grounds for creation of later congressional committees.

It also helped these committees in moulding and re-moulding their networks and persuading other actors (Senators or Congressmen for example) to enrol in these networks. Accordingly, the Ervin Committee was viewed "as a turning point in postwar political history" (Johnson 2006, p.205). Equally important the committee had a powerful effect on the expansion of 1970s investigations of the Senate subcommittees

as well as the SEC's increase of surveillance of multinational corporations that led to its voluntary program. The program required voluntary disclosure of illicit campaign contributions and bribery of political officials internationally and domestically. The SEC's voluntary program, as will be explained in detail in this chapter, and the recommendations of the program were the deciding factor for one of the network's to enrol the SEC as their dominant actor. The program also helped some of the committees in identifying the problem, formulating their networks and proposing a solution.

### 1.1 Ervin Committee Investigations

The task of the Ervin Committee was “much more difficult and complex” as “[i]t must probe into assertions that the very system itself ... [had] been subverted and its foundations shaken” (United States 1973b, Book 1 p.3). During the initial process of establishing the committee, letters were sent to Senator Eastland and Senator Ervin seeking expressions of interest in holding public hearings relating to the Watergate scandals. Senator Eastland was favoured by the White House, as it was perceived that he would be friendly and that they had more friends on Senator Eastland's Committee (United States 1973b, Book 3, p.980). After the Senate vote for Senator Ervin, the White House changed its strategy to “take a public posture of full cooperation” with the committee “but privately ... [to] attempt to restrain the investigation and make it as



difficult as possible to get information and witnesses” (United States 1973b, Book 3, p.984; United States 1974, p. 76). The ultimate goal of the White House was “to discredit the hearings and reduce their impact by attempting to show that the Democrats had engaged in the same type of activities as the Republicans” (United States 1973b, Book 3, p.984; United States 1974, p. 76).

## 1.2 Details of the Scandals

President Nixon at first was confident that “[t]here was no crisis” and that the hearings would “peter out quickly” (Ashby & Gramer 1994, p.403; United States 1973c). However, one needs to take into account that the Watergate break-in was just the tip of the iceberg. The evidence before the Ervin Committee revealed that the break-ins were organised and paid for by officials of the Campaign to Re-elect the President (CRP).

Initially, from the public view and that of the committee the truth was concealed. To hide the facts, documents were destroyed and shredded, moneys were offered and Executive clemencies were given (United States 1974, p.32). Throughout the Ervin Committee investigations, requests for access to information and political players were rejected. For instance, the President had directed the FBI to restrict the Watergate investigation to prevent exposure of the activities of a group called the Plumbers<sup>8</sup>, which was in charge of investigating the leaks of sensitive documents from the Pentagon to the media. For this reason, these cover-ups before and during<sup>9</sup> the Ervin

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<sup>8</sup> An in-house investigative arm of the White House, conducting political and national security related investigations during its existence in 1971 (United States 1974, p.119).

<sup>9</sup> A conference committee was established to deal with the Ervin Committee and to make sure that the cover-up would not be unraveled in this committee (United States 1973b, Book 4).

Committee investigations were successful as higher presidential campaign officials and the White House officials were not exposed.

Additionally, President Nixon argued that “I can state categorically that no one in the White House staff no one in this administration presently employed was involved in this very bizarre incident” (United States 1974, p.47). Yet, this claim was not based on any formal investigation even though Nixon claimed that he had assigned a White House staff member to conduct an investigation under his direction. The Justice Department's Director of Public Information declared as well that “the Department had concluded its investigation stating we have absolutely no evidence to indicate that any others should be charged” (United States 1974, p.48). By creation of the Watergate Special Prosecutor<sup>10</sup> during 1973, “a Pandora’s box of other significant and pervasive criminality” was opened (Biegelman & Biegelman 2010, p.8). Cases which “the Justice Department had almost never moved against illegal business contributions to political figures” were investigated (United States 1976a, p.95). This was also when the FBI did not have a “reporting category for business crime” in their “Crime in the United States annual report” (United States 1976a, p.95). In a news conference in August 1972, President Nixon was asked about the addition of an independent special prosecutor to investigate the Watergate case and he argued, based on the FBI’s “full field investigation”, the Department of Justice prosecution and the General Accounting Office independent investigation, “I don’t believe that adding another special prosecutor would serve any useful purpose” (United States 1973b, Book 4, p.1509). In addition, he

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<sup>10</sup> Professor Cox, a lawyer and law professor at Harvard University was appointed as the first Watergate Special Prosecutor. Upon his request for secret tapes of Nixon conversations, Nixon ordered his dismissal.

said that all of the Government agencies as well as the White House under his direction were fully cooperating with these investigative bodies (Woolley & Peters 1972).

### *1.2.1 The Campaign to Re-elect the President Committees'*

The Re-election Campaign that was involved in the break-ins consisted of two entities. One was in charge of political affairs (CRP, Political Committee), and the other raising funds and their distribution (FCRP, Finance Committee) (United States 1973b, Book 2). Most of the important positions in the campaign entities were given to White House aides (United States 1974, p.19). Hence, both of the entities were staffed and controlled by the White House. The Political Committee used a tactic called the “attack strategy” which later was “converted by others into gross abuses and unethical manipulations of the electoral process” (United States 1974, p.108). In respect to manipulation of electoral processes, Senator Inouye argued that

[u]nless we can safeguard ... [the] process from fraud, manipulation, deception, and other illegal or unethical activities, one of our most precious rights, the right to vote, will be without meaning. Democracy will have been subverted (United States 1973b, Book 1, p.8).

Details of the Finance Committee’s purpose and processes are explained in the following section.

### *1.2.2 Finance Committee*

The objective of establishing the finance committee was to raise sufficient money to cover the expenditures of the campaign committee (United States 1973b, Book 2). The importance of the finance committee was that “cash contributions and funds played key roles in virtually all aspects of the 1972 Presidential election” (United States 1974, p.108). As per the Ervin Committee’s investigations, large sums of money were “held in

secret places in the White House and elsewhere” (United States 1974, p.108) that were difficult to trace even though a new law called the “The Federal Election Campaign Act of 1971” came into place on 7<sup>th</sup> April, 1972<sup>11</sup>. The new law required record keeping of the funds raised and the details of the contributor, as well as the disbursement of the funds (United States 1974, p.26). The enforcement responsibility of the legislation was

upon the General Accounting Office ... [which] was limited to taking evidence of violations to the Department of Justice, which ... [had] failed to undertake vigorous prosecutions of delays or inadequacies in fund reporting (Mosher 1974).

It was argued by Stans, former U.S Secretary of Commerce and then chairman of the Finance Committee,

[b]ecause of the complexity of the new law that became effective in the course of the campaign and the vast amount of work that had to be done under the new law there may have been some unintended technical violations by the committee. ... [T]here were no intentional violations of the laws relating to campaign financing (United States 1973b, Book 2, p.689).

By not reporting the source of the funding and the amount that was available for expenditures, the committee was able “to finance the bugging and the burglary of the offices of the Democratic National Committee in the Watergate complex ... for the purpose of obtaining political intelligence” (United States 1974, p.1098) and “alleged hush money” (United States 1974, p.1109). As indicated by Senator Ervin, the people involved with the scandals

were not seduced by the love of money which is sometimes thought to be the root of all evil ... [but] were instigated by a lust for political power which is at least as corrupting as political power itself (United States 1974, p.1101).

The Ervin Committee investigations found that “at least 13 corporations made contributions totaling over \$780,000 in corporate funds ... [of which] approximately

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<sup>11</sup> The bill was signed by February 7, but it was not effective until April 7 to allow time for the transmission.

\$749,000 ... [were] illegal corporate contributions” (United States 1974, p.446). The contributions, which were mainly in cash and occasionally in corporate assets, were not recorded until July 1973 (United States 1974, p. 447). The motivation behind the disclosure was rooted in an “imaginative suit” against the Finance Committee’s records of the contributors which required them to disclose how the contributions were paid (United States 1974, p.447). Accordingly, the committee, in return, sent letters to individuals in corporations seeking details of these political contributions.

As per the Ervin Committee’s questioning, corporate executives were approached by the Finance Committee’s fundraiser personnel “searching for \$100,000 givers” (United States 1974, p.448) referred to as the “100 club” (United States 1974, p.505) to be in the good books of the government (United States 1973b, Book 13). The stated bases of the contributions were in relation to the President’s outstanding performance and the need for organisations to assist him along the road. The funds were requested by the fundraiser personnel to be given to the committee before the 7<sup>th</sup> of April 1973. As indicated by the American Airline former chairman “sometimes the fear of the unknown may be more terrifying than fear of the known” (United States 1973b, Book 13, p.5514). Also Senator Ervin commented that “[i]t certainly is a human weakness or desire for any one engaged in business to have a friendly ear in government” (United States 1973b, Book 13, p.5449). It was argued at the time since the CEO or executive salaries per year were far less than \$100,000; it was perceived that the political contributions had to be made from corporate funds (United States 1973b, Book 13).

“In many instances ... [the] contributions were carefully planned, artfully concealed and in no sense the fruit of illicit pressures” (Sommer 1975, p.1975). The funds were



sourced differently by the corporations. It needs to be considered that the political contributions and the reason for why the payments were made were not discussed by the board of directors or the shareholders. Rather it was apparent those who agreed to the payments argued “the reelection of the President was in the best interest” of their corporation or the U.S. (United States 1973b, Book 13, p.5530). As argued by the chairman of Ashland Oil during one of the hearings “[t]here was a good business reason for making the contribution and although illegal in nature I am confident that it distinctively benefited the corporation and the stockholders” (United States 1973b, Book 13, p.5447).

The majority of the corporations had used foreign subsidiary reserves (Swiss bank accounts) or expense accounts (such as research expenditure), and others had recorded the payments as either corporate expense or bonuses. The bonuses which were referred to by corporate executives as “bogus bonuses” (United States 1973b, Book 13, p.5425) were mainly recorded as the executives’ reimbursement for their contributions (United States 1974, Final Report, p.447) or overseas agents’ commissions. The next section will illustrate a brief summary<sup>12</sup> of some of the corporations under investigation by the committee, such as Ashland Oil, Gulf Oil, and Northrop Corp, that had paid political contributions. The reason for this brief summary is to illustrate how corporations were treating these payments in their books and records and were able to hide them from their stakeholders. The purpose is to shed some light on the importance of this study, the motivation behind the push for establishment of new legislation in later congressional hearings by the networks created and eventually the reason behind the need for including accounting requirements in this new legislation.

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<sup>12</sup> The summary provided in this study is not comprehensive, for full details refer to the Presidential campaign Activities of 1973 books and final report.

### 3. Instances of Political Contributions by Corporations

#### 3.1 Gulf Oil Corp

Gulf Oil Corp was one of the first corporations contacted during 1971 to contribute to President Nixon's re-election campaign as well as the Democrat candidate campaigns. The company had a history of making international political payments. For instance, during the 1960s payoffs were paid in Korea and Bolivia to help the recipients of the payoffs to get elected (Washington (AP) 1975). The contributions were made through the vice president for Government relations, Wild<sup>13</sup>, without any consultation with the chairman or the board of directors as he had "broad authority to handle governmental matters" (United States 1973b, Book 13, p.5465). Wild, from 1965, "was responsible for disbursing the cash" personally to "national political figures and was somewhat involved in making political payments in Texas" (McCloy et al. 1976, p.65). Those assisting Wild with political payments were advised to spend the money "in the general interest of Gulf and the oil industry" (McCloy et al. 1976, p.66). The money, in the form of cash, was taken from one of the Gulf Oil foreign subsidiary's in the Bahamas.

The subsidiary was in charge of oil exploration in the Caribbean area which "ended up as a vehicle for accumulating cash with which domestic political payments were made and for recording charges resulting from transfers of funds abroad for political purposes" (McCloy et al. 1976, p.4). It was liquidated in the fall of 1972 as Gulf had "embark[ed] on an overall cost-cutting program" and was eliminating offshore

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<sup>13</sup> In 1963, he "became the head of Gulf's Government Relations Department in Washington" (McCloy et al. 1976, p.63). Wild was the company's Vice President during 1968 to March 1974 and after his retirement he was "retained by Gulf on an emergency basis as a consultant in legislative matters" between 1974 and 1975 (McCloy et al. 1976, p.63).

subsidiaries with unsuccessful drillings (McCloy et al. 1976, p.54; United States 1973b, Book 13). All of the Bahamian offshore companies were “folded into a single new offshore investment company located in the Bahamas called Midcaribbean Investments Limited” (McCloy et al. 1976, p.54). By liquidating Bahamas, “the mechanism successfully employed since 1960 for providing cash for corporate political contributions disappeared” (McCloy et al. 1976, p.55). The reason for using the foreign subsidiary was that it was not required to consolidate the accounts in the financial reports of Gulf Oil<sup>14</sup>.

The Bahamas subsidiary internal control was non-existent in practice. The company’s operation “on its face was ... abnormal ... with a number of aspects which should have aroused the suspicion of any responsible control officer” (McCloy et al. 1976, p.220-221). The only control over disbursement of the funds to Wild was the accountability of the person in charge to his superior. Based on the available documents, the arrangements were designed in a way “to eliminate all corporate controls over disbursement of the fund” (McCloy et al. 1976, p.203). During 1967 to 1972, internal and external audit checks and controls were not performed on the Bahamas subsidiary, despite the fact that the external auditor, Price Waterhouse and Co, “had some knowledge of certain unusual transactions in Ecuador and in Switzerland” and the off-the-books accounts maintained in these countries (McCloy et al. 1976, p.208). Based on external auditors’ reports between 1960 and 1967, they had performed their normal audit procedures on the information (on-the-books accounts) they had access to which was limited and were not able to detect the concealed facts (McCloy et al. 1976). Lack

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<sup>14</sup> The company’s board of directors had assigned John McCloy, the chairman of the Gulf Special Review Committee, to prepare a comprehensive report in relation to foreign political contributions. The detail of this report is illustrated partly in this section and in the following sections.

of internal auditing was related to internal auditors not being “authorized to perform any auditing work at Gulf’s head office in Pittsburgh” (McCloy et al. 1976, p.209) and “lack of independence and structure” (McCloy et al. 1976, p.212).

The fund transfers to the Bahamas bank account “were recorded as deferred charges rather than cash transfers” (McCloy et al. 1976, p.40). The deferred assets were then written off “at the direction of accounting advices sent from Pittsburgh ... so that the transfer was cleared from balance sheet by year-end” (McCloy et al. 1976, p.53). The Bahamas books at no time maintained any

record of either deposits or withdrawals from the account ... nor did the company maintain as part of its records any bank statements or documents indicating that such an account existed and contained company funds (McCloy et al. 1976, p.42).

The political contributions from these funds were maintained off-the books and recorded as part of the travel and entertainment or miscellaneous expense account. With no documentation or record keeping system in place for these expenditures, “[t]he accounting entries on the Bahamas Ex. Books were really fictitious” (McCloy et al. 1976, p.221). To not “stir the water” in the corporation or “attract public attention” as stated by Wild, the contributions were paid in cash (United States 1973b, Book 13, p.5470).

By 1973 the Finance Committee initiated requests of corporations to grant them authority to disclose the name of the contributors. Wild was contacted to disclose the names of employees who had contributed, as previously explained in this chapter. However, because of the seriousness of the situation the matter was discussed with the chairman of Gulf Oil and a letter was sent to the Finance Committee requesting a refund of the \$100,000 (United States 1973b, Book 13).

### 3.2 Ashland Oil Co Inc

Ashland Oil was one of the corporations approached prior to April 1972, to make a \$100,000 political contribution and a payment of \$10,000 for advertising in the Republican convention brochure (United States 1974, Final Report, p.459). The chairman of Ashland Oil, Atkins, assumed the contributions were to be made from the corporation's fund, as \$100,000 was "an awful lot of money" and it was not "practical to raise it from any other source" (United States 1973b, Book 13, p.5441). He knew the contribution was illegal but he viewed it "as somewhat analogous to the situation in prohibition, the Volstead amendment<sup>15</sup>, where it was more honored in the brief than by observation" (United States 1973b, Book 13, p.5442). In a letter to an Ashland Oil stakeholder, Atkins states "[t]here was a good business reason for making the contribution and, although illegal in nature, I am confident that it distinctively benefited the corporation and the stockholders" (United States 1973b, Book 13, p.5802). Atkins's good business reason was to have competitive advantage over governmental policies. He argued,

being a relatively unknown corporation despite our size we felt we needed something that would be sort of a calling card something that would get us in the door and make our point of view heard (United States 1973b, Book 13, p.5441).

The contributions were paid from its African subsidiary account. The subsidiary was mainly in charge of oil exploration in Africa and not all of their oil drillings were successful. The contributions were recorded as a capitalisation of investments and expenditures in relation to the land being explored, called "undeveloped leasehold

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<sup>15</sup> Volstead Act, formally the National Prohibition Act, was enacted in 1919 to provide enforcement for the Eighteenth Amendment, prohibiting the production, sale and distribution of alcoholic beverages (<http://history.house.gov/Historical-Highlights/1901-1950/The-Volstead-Act/>).

account” for the purpose of not writing the amount off for tax purposes (United States 1973b, Book 13, p.5443). The money was transferred from a Swiss Bank so as to “not excite anybody's curiosity” in the U.S. (United States 1973b, Book 13, p.5444). As the payments were made prior to 7 April, Atkins assumed the contributions would “be secret and not disclosed” by the Finance Committee (United States 1973b, Book 13, p.5441). However, the Finance Committee later announced that Ashland Oil’s chairman and his wife were the sole contributors of the \$100,000, which was without their consent. Ashland, similar to Gulf Oil, was another company writing to the Finance Committee claiming that it had paid illegal political contributions and requesting a refund of the money.

### 3.3 Northrop Corp

Northrop Corp had made a “sizable contribution” of \$150,000 as requested from corporate funds to the re-election campaign in 1972 (United States 1974, Final Report, p.487). However, in response to the questionnaire that was sent by the Ervin Committee in regards to illegal contributions made out of corporate funds, the corporations’ vice presidents and CEO had claimed that the contributions were personal and that the corporation’s funds were not utilised. The investigations had revealed that \$100,000 of the contributions, which was Northrop corporate funds, in the form of cheques and \$50,000 in cash were made through Northrop’s European business advisor, Savy, who had “been remitting a portion of the Northrop money” (United States 1974, Final Report, p.487). The payment was recorded as “additional fees and other compensation” (United States 1974, Final Report, p.487).

As the contributions were going to be publicly disclosed by the Finance Committee, the CEO assured the authorities in charge, the funds were not paid from the corporation and refused the return of the monies. To conceal the origin of the payments, the CEO and vice presidents agreed to prepare fake documents, supporting documents, and “promissory notes backdated” to prior to April 1972 and payable by 1973 (United States 1974, Final Report, p.488). To cover the payments made through Savy, the amount was to be recorded “as an advance made in contemplation of substantial new efforts ... to market a particular Northrop aircraft to NATO countries” (United States 1974, Final Report, p.489). The CEO and vice president also prepared documentation to represent arrangements with Savy to return the unused portion of the funds. A portion of the money was supposedly returned with a correspondence explaining this refund as a result “of the failure of the contemplated marketing effort” (United States 1974, Final Report, p.489). Northrop’s CEO personally delivered the above documentation to the Finance Committee.

### 3.4 American Ship Building Co

The American Ship Building treatment of the political contributions was quite different from the above mentioned cases. The CEO and chairman of the company, Steinbrenner, had asked the treasurer and secretary to prepare a list of eight “trusted employees” to whom bonuses could be granted (United States 1973b, Book 13, p.5420). The bonus cheques were issued to employees to pay for the re-election campaign prior to April 1972 (United States 1973b, Book 13). The cheques were deposited in their bank account and a personal cheque was issued for the political contributions. The bonuses were recorded as expenses in an account named “researcher claim” (United States 1973b,

Book 13, p. 5424). This account was not “presented for payment but rather taken as a deduction for tax purposes” (United States 1974, Final Report, p.453).

This meant that the taxpayers were taking on the cost in part. Steinbrenner, based on the testimonies, had personally contributed \$75,000 to the re-election campaign, which, according to the investigations, happened to be the same amount that he had received as a bonus payment 1.5 years beforehand (United States 1973b, Book 13, p. 5423-24). In total the American Ship Building Company had paid \$100,000 in political contributions as it was said “the Republicans were going to win big” this time and it was important “to get with the right group” (United States 1974, Final Report, p.451). Because the company “was involved in two major matters with the Government” it had to make a substantial contribution as the payments of \$25,000 or \$50,000 would have been “amongst many, many thousands that ... probably would be lost in the shuffle or wouldn’t be remembered” (United States 1974, Final Report, p.452).

When the company was investigated by the FBI, the lawyer for the company told the employees to argue the money was their own and to state the payment was made due to their future interest in the ship building industry and “backing the Nixon administration which ... helped the industry” (United States 1973b, Book 13, p.5409). As far as the bookkeeping was concerned, in 1973 the CEO requested false memos regarding a “legitimate bonus payment plan” for “cosmetic purposes”, to show the bonuses were paid for the extraordinary performance of a division of the company in 1971 and 1972 (United States 1973b, Book 13, p.5425). The bonuses were approved by the board of directors. During 1973, the president of the American Ship Building Company made the employees sign a false statement, backdated to 1971 and 1972. The statement was about



the bonuses from the company being based on their performance and not connected with receiving any instruction from the company in using these bonuses for political organisations. The statement also indicated any political contribution made by these employees was “a bona fide one, made voluntarily of ... [their] own choosing” (United States 1973b, Book 13, p.5425). Since the story was hitting the newspapers, the employees were anxious and so were asked to take some time off from work (United States 1974).

#### **4. The SEC's Voluntary Program**

As explained before, the above and similar cases were investigated by the Ervin Committee. The congressional hearings and testimonies relevant to these cases, during 1972 to 1974, had created “great television fare” (Sporkin 1997, p.271). Head of the SEC's Enforcement Division, Stanley Sporkin<sup>16</sup> was following these hearings via television as the corporate officers' testimony was intriguing for him. From his viewpoint, “the committee [had] made no searching inquiry into the methodology used by the corporations to make the payments” (Sporkin 1997, p.271). He was also questioning “[h]ow did a publicly traded corporation record such an illegal transaction? What, if any, information did the outside auditors have?” (Sporkin 1997, p.271).

Sporkin's curiosity initiated an informal investigation which led the SEC in 1974 to inquire into corporations' disclosure of illegal political contributions. The facts uncovered by the Special Prosecutor's office and the Watergate Committee were reviewed by the SEC (Nelson 1976). It was revealed that the federal securities law was

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<sup>16</sup> Sporkin was licensed as a Certified Public Accountant (Sporkin 1997).

violated as financial records were falsified “to disguise or conceal the source and application of corporate funds misused” and secret payments were made “outside the normal financial accountability system” (Nelson 1976; United States 1976n, p.3). The magnitude of falsification of corporations’ books and records, as “the very foundation of the disclosure system” (United States 1976n, p.3), provoked the SEC as the “American’s corporate policeman” (United States 1976m, p.483) in 1975 to initiate its first Voluntary Disclosure Program (Brodsky et al. 2008). The program was established by Sporkin (Lacey & George 1997-1998; Sporkin 1997). Even though the Ervin Committee and other committees shed light on the illegal political payment contributions’, the SEC program led to “far broader disclosures of corporate wrongdoing that followed” (Stevenson 1976, p.53).

The SEC was able to require corporations to submit information or reports in relation to foreign bribes and payoffs, based on its power under the Securities Exchange Act of 1933 and 1934. The rule gave the SEC the power to ask corporations to provide “necessary or appropriate [information] in the public interest or for the protection of investors” (United States 1976i, p.69). However, the program was performed

with minimum resources, using the strength of the private sector ... to undertake the corrective action in cleansing the enterprises and in uncovering the past conduct and in bringing it out to the investor and the public through disclosure ...[and] the voluntary programs that were started or engendered by the Commission’s suggestion (United States 1976l, p.9).

Information gathered by corporations voluntarily, would have helped the SEC to investigate illegal payment cases further and in a timely fashion without having extensive staff. The SEC also had requested corporations to submit the information in

the form of publicly available reports such as the McCloy<sup>17</sup> report that was prepared for the Gulf Oil Corporation. The details of the report will be explained in the following section of the chapter. In return the SEC promised lenient prosecution and enforcement action against volunteers. As the program progressed, guidelines and procedures were developed for corporations to undertake in order to disclose the illicit payments.

The SEC initially “was subject to substantial criticism... on the grounds that [bribery] was the normal way of doing business abroad and that shareholders had no right to such information” (United States 1977d, p.1). Regardless, this rationale and similar ones were deemed to deserve examination by them. The SEC’s reaction to revelations pertaining to concealment of bribe payments and international corruption demonstrated that it was “the only [small independent] Agency ... [not] asleep” (United States 1976l, p.9). On this matter, it seemed other Government agencies had been “sitting on their hands or aiding and abetting the payment of bribes and kickbacks” (United States 1976a, p.39).

The accounting profession and accounting bodies were passive on this matter, while the SEC program was along the lines of suppressing fraud (United States 1976m). Their lack of involvement, as will be extensively explained in chapter three, was partly due to the fact that the accounting profession was under pressure from the Congress. The pressure was in relation to its lack of competence in regulating members of the accounting and auditing profession, who demonstrated a lack of independence in performing audit procedures and standard setting processes (Holtzman 2004; United

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<sup>17</sup> John McCloy had a “distinguished record of Government service” (United States 1976i, p.3).

States 1976b; United States 1977a; Zeff 2003a). Chapter three will explain the issues and difficulties the accounting profession and accounting bodies were facing during the 1970s.

From the SEC's perspective, the essential problem was in relation to the system of corporate accountability, where information was intentionally concealed from the board of directors and independent auditors (United States 1976a). Accordingly, the SEC mainly focused on "full and fair disclosure" with "the question of whether the funds were used for the payment of bribes to secure business helped [in] establish[ing] the materiality of the evidence" (Posadas 2000, p.351). The SEC relied on the "materiality doctrine", which was based on a qualitative standard, for this matter (United States 1976l, p.1). The rule was, disclosure of payments that were material to investors or related to wasting corporation's assets. This meant not all the payments, regardless of their size, had to be disclosed even though the payment was "illegal under foreign law" (United States 1976l, p.7). These measures were based on the SEC's tradition of assuring the financial statements accurately informed the public of all the material matters (United States 1976l). The then SEC chairman, Garbett, in a speech stated

if we require disclosure of all violations of laws against bribery or political contributions on the ground that illegal payments are material *per se*, we may be hard pressed to explain that other illegal corporate acts are not equally material for the same reason (United States 1975a, p.60).

However, the doctrine was questioned later by one of the Senators, William Proxmire<sup>18</sup>, as the SEC could not "quite define what sort of bribe is material under existing law, but

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<sup>18</sup> Extensive details about Proxmire will be provided in the following chapters.

they know it when they see it” (United States 1976l, p.2). The Commission’s chairman noted that the problem with defining the term ‘materiality’ was a matter they had been struggling with for many years. The committee had observed that it was “not possible to develop an objective definition of materiality that will have general applicability to all fact situations” (United States 1977e, p.322). Nonetheless, defining the term was “not the real issue” that had to be overcome in the hearings later held by Proxmire (United States 1976l, p.8). The real issue was establishment of new legislation, in relation to disclosure, to curb illicit payments, and to assure that this problem would be solved.

The program required companies under the SEC rulings to conduct independent investigations of their past financial statements and reports. If the investigations suggested occurrence of illicit payments, the board of directors of the company had to be informed to modify the statements, consult with the SEC and also to authorise a complete investigation (United States 1976a). The complete investigation was to be undertaken “by a committee consisting of independent” members of its board of directors (United States 1976a, p.10). However, as will be detailed in chapter four, the reliance of the investigations on boards of directors was questioned by Proxmire and other witnesses present during one of the Senate hearings.

The SEC had advised the corporations to seek assistance from their independent auditors in this regard. The SEC hoped investigations by corporate management with the assistance of independent auditors would be thorough and lead the board of directors to attempt to change and reiterate policy statements, and implement “adequate internal controls and safeguards” to be “monitored by auditing programs established by the

independent auditors” (United States 1976n, p.10). The program was viewed by the SEC as the “new governance concept” and believed it would help to “strengthen the quality of corporate management and public confidence in business over the long run” (United States 1976n, p.55-56). Hills<sup>19</sup>, SEC Chairman, stated that “the future is taken care of certainly in all the enforcement actions we brought simply by the fact that we changed the governance of the corporation” (United States 1976f, p.313).

#### 4.1 The McCloy Report

As explained previously, the SEC had requested corporations to submit public reports in relation to details of their illicit payments. John McCloy was assigned as the chairman of the Gulf Oil Special Review Committee, by the company’s board of directors, to prepare a comprehensive report in relation to foreign political contributions in March 1975 (United States 1975e). The SEC was mainly “interested in exploring the facts as to how such illegal activity could happen within the framework of a large corporation with built-in controls such as Gulf” and not just the methods used by Gulf Oil or any outside parties (United States 1975e, p.13). McCloy as a lawyer and a director of Gulf Oil since 1969 (United States 1975e), previously was an advisor to President Nixon and during this time was a partner in Milbank, Tweed, Hadley and McCloy law firm (known as Milbank) in New York<sup>20</sup>. The report was subsequently presented at one of the Proxmire hearings explained in chapter four.

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<sup>19</sup> Roderick Hills served as the SEC’s chairman from 1975 to 1977.

<sup>20</sup> McCloy as a partner in Milbank, acted for the “Seven Sisters” (the leading multinational oil companies, including Gulf Oil), in their initial confrontations with the nationalisation movement in Libya, as well as negotiations with Saudi Arabia and OPEC (<http://polioforever.wordpress.com/john-j-mccloy/>).

The report was called “ the great oil spill” and covered around 13 years of contributions that “were paid out of an off-the-books account” amounting to around \$5 million (McCloy et al. 1976; United States 1976i, p.5). The findings and recommendations were based on the evidence which the committee was able to discover as well as Ervin Committee investigations, explained briefly in this chapter, and Church Committee hearings, which will be demonstrated in the following chapters. The SEC did not expect McCloy “to audit Gulf Oil Corporation’s books and records” but to

be free to conduct as full an investigation of the relevant facts as ... deem[ed] necessary to provide the Commission and the investing public with an independent and thorough appraisal of matters (United States 1975e, p.21).

The committee in charge devoted the majority of its efforts

to the task of establishing the extent of knowledge, if any, among Gulf’s senior executives of the use of company funds for political activities, both in the United States and abroad (McCloy et al. 1976, p.224).

The committee’s investigation in relation to the external auditors, Price Waterhouse and Co, was “limited to those matters which came to its attention in the course of its review of various specific transactions” (McCloy et al. 1976, p.205). Some of the material available to the committee made it clear the external auditors had knowledge of bribery and illicit payments, as explained previously in this chapter. Also, in the committee’s meeting with Price Waterhouse and Co, they received “certain materials ... including a report summarizing their knowledge of Gulf political contributions, particularly the use of the Bahamas Ex. account”, the matter was not reviewed or investigated further (McCloy et al. 1976, p.23).

The committee, also, did not “investigate the nature of Gulf’s domestic political contributions” before 1958 (McCloy et al. 1976, p.61). This was because, the company in 1958 had announced that in the future it would “take an increasingly active interest in practical politics” which led to formation of “A Political Program for Gulf Oil Corporation” (McCloy et al. 1976, p.61). The program was partly rooted in Wild’s statement in relation to Gulf being kicked and “knocked around by the government for a long time and that the time had come to do something about it ... to have its voice heard in government circles” (McCloy et al. 1976, p.63).

Some of the foreign political payments “were either legal or customary where they were made, and they seem to have been in large part induced by pressure from governments or political parties concerned” (United States 1976i, p.5). The committee on this matter, had found that corporate funds which were “used abroad for political contributions or related expenses were so used to accomplish what was deemed to be a corporate purpose” and no evidence was found to suggest “such funds were recycled in any manner into the United States for the purpose of providing funds for domestic political contributions or related expenses” (McCloy et al. 1976, p.93). The Governments’ pressures for these payments were common in both underdeveloped and developed countries. For instance, in relation to Gulf dealings with South Korea, the company “had no desire to make” these payments (McCloy et al. 1976, p.103). The payments were initiated by the South Korean Government, so that Gulf would be able to “to prosper and do well” (McCloy et al. 1976, p.102). McCloy’s observation was that there was need for future guidelines for companies, since from his experience from preparing the report, “the barn door ... [was] well fastened” (United States 1976i, p.7).



McCloy's argument was that the SEC's efforts while the voluntary program was in place, had been effective in the "alteration of attitudes" and doubted "any [need for] new substantive legislation" (United States 1976i, p.7). He believed in the movement that was taking place in U.S. corporations due to their "definite alertness and awareness to this whole problem that hasn't existed before" (United States 1976i, p.14). Corporations' "tone of the top management" had started reforms in industry (United States 1976i, p.14) which was ideal from McCloy's perspective. Hence, there was no need for having a body or

somebody ... looking over the shoulder of the executives forever. ... I believe the multinational corporations are highly desirable figures in our economy and it isn't synonymous with vicious behavior (United States 1976i, p.15-16).

McCloy felt corporations were over victimised as they were "just another American citizen" that in the process of disclosing their foreign payments had "shown alertness and strength" (United States 1976i, p.16).

## **5. Conclusion**

The Ervin Committee prepared a final report in relation to the hearings that were held and detailing cases of corporations that had used foreign subsidiaries and banks to launder corporate funds in order to contribute to the Re-election Committee in cash (United States 1974, Final Report, p.567). The report also demonstrated the ability of the Re-election Campaign Committee to conceal the source of the money and the way it was used. This explains the way political powers can blind people in charge to forego "ethical considerations and legal requirements" (United States 1974, Final Report,

p.1102). As part of the investigations by the Ervin Committee the corporations were fined various amounts (\$1,000-\$5,000), which meant that the stakeholders were affected by these payments, even though they were not consulted in relation to the political contributions

The final report also made recommendations in relation to enactment of new legislation. These recommendations were mainly related to the Presidential election process, limitation of public contributions in the form of cash and cheques to name a few. Accordingly, there was a need for the SEC and the accounting profession to step in and investigate the lack of disclosure or accounting processes used by corporations. Also, as the independent auditors had not detected these false recordings, action by the accounting standard setting body of the time was required and necessary.

The SEC initiated its first Voluntary Disclosure Program under Stanley Sporkin's supervision, in 1975. The program requested corporations to conduct independent investigations and disclose their material illicit and questionable payments made domestically and internationally. Companies' concealment of information from boards of directors, shareholders, and external auditors was alleged to be the shortcomings of the system of corporate accountability. The program helped the SEC and the Congress to compose the accounting provisions of the proposed bills leading to the FCPA, as well as strengthening the aim of the networks that were created by Senators during the 1970s. However, as will be argued in subsequent chapters, the proposed reforms had "not moved to the Senate floor" promptly and even if they did, they had "rather low priority in the Congress and there ... [would be] no priorities in the White House to push for these changes" (United States 1976i, p.17). The accounting profession, as

having their own network and separate from the congressional attempts, also had turned a blind eye to these concerns and had not initiated any new auditing or accounting standards or even a study in this regard.

# Chapter Three: The Accounting Profession's Reaction to the Scandals

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*The story of the apocryphal accountant who, when asked the sum of 2 plus 2 replied, "Well what did you have in mind?" Mark Twain suggested: "Things are bad when you're publicly criticized; things are disastrous when you're laughed at." (cited in United States 1977a, p.17).*

Chapter two demonstrated the response of the 1970s Congress to the public outcry regarding the issues surrounding the Watergate scandal. During this time period, investigations and hearings were held in relation to the scandal which shed light on multinational corporations' concealment of domestic and foreign political contributions and foreign bribes. The illicit payments made by executives, in a majority of instances, were not discussed by the board of directors or independent auditors. As far as the accounting treatment of these funds is concerned, the political payments if recorded in the company's books, were either recorded as an expense or bonuses to employees and executives. The Ervin committee's questioning opened a can of worms in relation to record keeping and corporate accountability to the public. These revelations kindled the interest of the SEC in finding out the way these corporations were able to hide their wrong doing from the public, accounting profession and independent auditors. The issues exposed were at the heart of accounting and auditing standard setting, disclosure requirements and reliability of financial statements.

As explained in the introduction chapter, during this time period the accounting profession was under pressure by the Congress because of its lack of competency in setting accounting and auditing standards as well as lack of independence in performing accounting and auditing services. In this context and based on ANT, it can be observed that the accounting profession and the big eight accounting firms had formed allies and their own network to avoid any government interference in the standard setting process. The aim of the network was to retain its power and ability to self-reform and self-regulate. As will be demonstrated in the following chapters, the networks that were created or re-created in relation to the problem of illicit payments were not supported or combined with the network already formed by the accounting profession. The accounting profession network, however, had not been successful in responding to public criticisms and resolution of fundamental accounting issues, leading to government supported inquiries during the 1970s, 1980s and even during 2000 after the Enron scandals. The inquiries were generally related to the “need for greater accountability” and independence of auditors in their work (United States 1976b, p.105), since as corporations have grown larger, the level of accountability advocated by the profession and the accounting firms has diminished (United States 1976b). As will be explained in this chapter, in response to these criticisms, the accounting profession was prompted to establish task forces to investigate the matters raised in response to the revelation of illicit payments by corporations.

Repetition of the inquiries over time and details of those inquiries are demonstrated in this chapter. From analysis of successive inquiries it can be deduced, asserted reforms instituted by the accounting profession were sometimes rushed, and mainly constituted

cosmetic changes to show that some adjustments had been made. However, there was no fundamental improvement. The aim of the accounting profession was to maintain their system of self-regulation and avoid additional regulation by Congress. This was achievable by the accounting profession, since the American Institute of CPAs (AICPA) “as the dominant private accounting organization” had “extended its power and influence beyond its position ... through close relationships with Federal agencies and State boards of Accountancy that regulate the accounting profession” (United States 1976b, p.70). It had advocated for Federal officials and the public “to lower their expectations” in relation to corporate accountability “through legislative and publicity campaigns to re-educate the public” based on this lower standard (United States 1976b, p.69). The other issue was the ability of the AICPA to make decisions “in the backroom”, while claiming to be acting in the name of protecting the public interest (United States 1977a, p.379).

This chapter will explain the events surrounding the accounting profession being under public scrutiny prior to the Watergate scandal, as well as the impact of congressional “post-Watergate morality” (Koehler 2012, p.938). The explained events demonstrates the accounting profession’s conspicuous absence and low profile in the congressional investigations and hearings that led to the FCPA. The absence of the accounting profession can partly be explained by their perception, the self-regulation and disclosure system was “second to none in the world” and their lack of eagerness to change the system in place (United States 1977a, p.98). The other reason as stated by Olson (1982, p.33), a former president of the AICPA, could be that “the Institute’s Washington office was ill-prepared to cope with the increased governmental pressures” during the 1970s.

Also, up to this time, the AICPA dealings with the Congress were mainly “confined to the expression of views on proposed tax legislation” (Olson 1982, p.35).

During this time period, Congress was purportedly searching for a solution to the problem of corporations’ illicit and political contributions that had revealed apparent accounting and audit deficiencies. It is important to highlight the problems and deficiencies raised in relation to the accounting profession, in order to set the context and environment in which the illicit payment hearings and proposed legislation were established. For this reason, this chapter will address the deficiencies and issues with the accounting profession commencing with the dismantling of the Accounting Principles Board (APB) during the 1970s.

## **1. Initial Concerns with the Standard Setting Process**

During the 1970s, as briefly explained in the introduction chapter, a push for replacing the APB was evident. The APB was initially established in 1959 after criticism of the accounting guidelines and principles for “preparation and certification of financial statements” (American Institute of Certified Public Accountants 1972, p. 17). The criticisms were in relation to alternative accounting methods or the absence of acceptable alternatives. The AICPA, as “the most powerful and influential force in shaping the environment in which accountants operate” (United States 1976b, p.70), established the APB with dual purpose. The purposes were “the elaboration of a conceptual framework and the development of positions with regard to specific

accounting principles and practices” (Sommer 1974, p.5). However, “the conceptual framework took a secondary role” (Sommer 1974, p.5).

The Board was mainly in charge of setting accounting standards, while the SEC had the “right to reject or modify ... [its] pronouncements” (American Institute of Certified Public Accountants 1972, p.25). The SEC, during the existence of the APB, issued pronouncements regarding “matters of accounting practice”, comprising “Accounting Series Releases or opinions of the Chief Accountant ... considered ... to be interpretative rules” or statements of policy (American Institute of Certified Public Accountants 1972, p.51). However, by the mid-1960s the APB was facing problems and criticisms of its accomplishments and structure. The handling and completion of research projects pertaining to pronouncements and standards, was time-consuming. Its “opinions became less and less animated by theoretical concepts and more and more by the pragmatic necessities of gaining two-thirds majority of the Board” (Sommer 1974, p.5).

The processes and means by which standards, and principles were established were moving towards not being “content to express opinions” but to issue “hard-and-fast rules and directives” (American Institute of Certified Public Accountants 1972, p.37). This led the pronouncements to “become increasingly lengthy, detailed and subject to controversy” (Sommer 1974, p.5). For instance by 1969, the board issued Opinion number 15 in relation to “common stock equivalents and related matters on earnings per share” (Sterling 1974a, p.318). The rule was a detailed sixty one page document, replacing a one sentence principle in relation to the same matter. Savoie (1974a, p.318) criticised the detailed ruling claiming it to be plugging loopholes “to provide a safe



haven for an accountant who follows them”. The issues of concern were partly due to the structure of membership being part time and unpaid which meant that there were minimal opinions released by the members on the matters at hand. This caused the board to lose “opportunities to educate the accounting profession as well as the entire financial reporting community” (American Institute of Certified Public Accountants 1972, p.38). Nevertheless, the SEC was unable to use this opportunity “to prod itself from its spectator role and to take charge” (United States 1977a, p.25). The SEC’s performance was largely “ceremonial and caretaker” and it preferred to step in only when it felt that the accounting profession did not have the capabilities which was rare (United States 1977a, p.26).

Also, the board operations were “on an ad hoc basis” (United States 1977a, p.25). Based on the observation of Burns (1974b, p.332), three quarters of “the research studies published by the APB through 1972 were started” in earlier years, 1960 and 1961 and since then, no new studies was started or undertaken. The espoused reason for this included the “rapid expansion of accounting firms ..., the development of increasingly complex and innovative business practices, and the corporate merger movement” (American Institute of Certified Public Accountants 1972, p.3). Business Combination accounting, for example, was one of the two topics that became a “highly controversial and emotion-charged issue” between 1963 to 1971 (Sterling 1974a, p.318). At the time, the topic was widely debated since corporations had “an eye towards instantaneous growth in earnings” (United States 1977a, p.25; United States 1985). In order “to create higher stock market prices” (United States 1977a, p.25; United States 1985), corporations pushed for the pooling of interest method. This method in comparison to the APB’s preferred purchase method, would not have accounted for goodwill and

would have allowed the combined company to report and reinstate the acquired company's prior period incomes as their own income, leading to inflating company earnings (Briloff 1972). The APB was under intense pressure by the industry and the accounting profession to back away from abolishing the pooling of interest approach. According to Savoie (1974a, p.325) "some groups wrote to key congressional committees suggesting this subject should more appropriately be left to the legislative and regulatory functions of the federal government".

The criticisms surrounded the APB's "inability to solve the abuse of the pooling of interests accounting for business combination technique" regarding the merger movement (United States 1985, Part 1, p.22). The body was not able to rule out the pooling method and by the 1970s issued two separate Opinions simultaneously, one relating to Business Combination and the other to Goodwill and Intangible Assets (Briloff 1972). The reason for the issue of two Opinions was because the APB required a vote from "one of the major firms" to reach "the required twelve affirmative votes" (Briloff 1972, p.89). The firm was in agreement with the Business Combination Opinion without the inclusion of Intangible Assets or Goodwill. This controversy and inability of the APB to reconcile the issue, resulted in the standard for Business Combination to be split into two separate Opinions with loopholes and loose requirements (United States 1977a). It also eventually lead to the abandonment of the APB which "was essentially closing the door after the horse had left" (United States 1977a, p.25).

## 2. The FASB Establishment

The above concerns and the AICPA's attempt to resolve the issue in house and as part of their formed network, led to establishment of the Wheat Committee. The committee prepared a report called 'Establishing Financial Accounting Standards'. One of the recommendations of the report was the establishment of the Financial Accounting Standards Board (FASB), as a new actor of the profession's network, and a self-regulatory board, independent of government with the AICPA and non-AICPA members. Mattli and Buthe (2005, p.409) described the FASB as "a novel structure of private-sector standardization that represented a bold experiment in self-regulation, with both legislative and judicial qualities". The AICPA touted the formation of the FASB as a "major, even revolutionary, shift" in accounting standard setting (United States 1977a, p.123). This point of view was probably announced to eliminate any government intervention. The recommendation was based on the committee's conclusion that it was

essential that the private sector standard-setting body become more actively and intimately involved with the concerns of agencies of government which may possess the power to override its standards in areas of their jurisdiction, demonstrating to them, in turn, that usefulness to investors must be the basic consideration in financial reporting (American Institute of Certified Public Accountants 1972, p.54).

The FASB, in practice, gave the AICPA the assurance of retaining its authority over setting accounting standards within the private sector. It was established and organised in a fashion to ensure it would "be responsive to the private interests of the groups that have created it" (United States 1976b, p.130) as the decisions were "made behind closed doors by private parties with a vested interest in the outcome" (United States 1976b, p.136). In theory, the AICPA was claiming otherwise, by stating that the final authority for establishing accounting standards, was with the FASB which was "independent of

the institute” and no longer in the hands of “[t]he Institute and practicing accountants” (United States 1977a, p.123).

The AICPA was the only private organisation that “could create a body to set accounting standards and immediately bestow upon it the reputation of being [an] accepted source of authority within the private sector” (United States 1976b, p.157). Meanwhile, the SEC’s then chairman believed that “reliance on the private sector for solving financial measurement problems ... [had over the past years] served investors well” and the pursuit of this policy was the way forward (Garrett 1973, p.5). The big eight accounting firms, as actors of the network, accepted the FASB pronouncements and standards from its establishment and “agreed to a system of enforced compliance with” them (United States 1976b, p.157).

The Wheat committee report also proposed paid and full time members for the FASB as opposed to the part-time, unpaid APB members to maintain a sound standard setting function in the private sector. The AICPA played “a key role in selecting its members” (United States 1976b, p.13). The FASB was structured to be operated by a non-profit corporation called the Financial Accounting Foundation (FAF) which was operating under the AICPA and private interest groups such as the American Accounting Association<sup>21</sup>, the National Association of Accountants<sup>22</sup> to name a few (United States 1976b). This structure was created to have the FASB establish accounting standards in a way that would appear to be independent, unlike the APB, “to boost its credibility

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<sup>21</sup> The American Accounting Association was “influenced by the big eight accounting firms through financial support and individual membership (United States 1976b, p.26).

<sup>22</sup> The AICPA had extensive influence over the National Association of accountants as well.

beyond that of the previous standard-setting bodies within the private sector” (United States 1976b, p.142). The then Chairman of the FASB, Armstrong<sup>23</sup>, as an actor of the network, was certain that “the spirit of independence” was driving the boards functions (United States 1977a, p.176).

As argued before, the independence and separation of the FASB was “one in name only” (United States 1976b, p.15). On the one hand, it represented “only the interests of its private sponsoring groups” (United States 1976b, p.19). On the other hand, the private interest groups, business groups, the accounting profession and the AICPA were in charge of financing the FASB’s operations and expenditures (Mattli & Buthe 2005; Sommer 1974; United States 1976b). These contributions were the means of controlling and aligning the activities of the FASB with their interest. For instance, business groups could have pushed for their demands and interest through the voluntary donations they made to the FAF which confirmed the FASB’s “continuing financial viability” (Mattli & Buthe 2005, p.410). This control from large accounting firms was seen as an opportunity to “increase their ... image with the public and with their clients” (United States 1977a, p.375). The primary contributions were from the AICPA with the large accounting firms donating “about half of the money contributed” (United States 1976b, p.14). However, the AICPA claimed that their opinion “is no different from any other group having opinions about financial accounting standards” and that their “advice does not prevail” (American Institute of Certified Public Accountants 1977, p.17)

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<sup>23</sup> He was the chairman of the FASB until end of 1977.

As stated by the SEC's then chairman, Garrett, the FASB was "the offspring of the accounting profession and the profession has the right to be proud of it" and that "the board is pursuing a logical course, that its members and staff have been well selected and ... its institutional structure is sound" (Garrett 1973, p.4). The Commission's recognition of the FASB was based on its professed belief that it "would provide an institutional framework ... [permitting] prompt and responsible actions flowing from research and consideration of varying viewpoints" (United States 1976b, p.177). However, not everyone was in agreement with Garrett after the FASB began operations. Senator Lee Metcalf, Congressman Moss and Associate Professor Robert Chatov<sup>24</sup> were among the many who questioned the FASB's legitimacy and authority and were the outside actors to the accounting profession's network.

Senator Metcalf, chairman of the Senate Subcommittee on reports, accounting, and management, argued that the formation of the FASB was an AICPA attempt to respond to the major problems the accounting profession was facing. The FASB was established with the hope of achieving "serious reform by establishing a system of uniform and meaningful accounting standards" (United States 1976b, p.16). However, it "resulted in [an] .... inadequate system of establishing accounting standards" (United States 1976b, p.12) which "affect[ed] the Federal Government and the public" (United States 1976b, p.13). Also, as the FASB was established to be independent, the private interest groups were not "suited to control the setting of accounting standards" (United States 1976b, p.13). Accordingly, Metcalf, in 1976, initiated a study in relation to "organizations and

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<sup>24</sup> He had authored a book in 1975 called "Corporate Financial Reporting: Public or Private Control" (United States 1977a, p.20).

agencies comprising the accounting establishment” (United States 1976b, p.iv). The details of the study and their key findings are discussed below.

### **3. The Accounting Establishment Study**

The Senate Subcommittee on reports, accounting, and management “began a study of the federal government’s role in establishing accounting practices” in 1975 (United States 1976b, p.iii), since “[a]ccounting issues ... [were] too important to be left to accountants alone” (United States 1976b, p.2). It was

the first time in nearly forty-five years ... [that] the purposes behind corporate financial reporting ... [were] carefully examined as [well as] ...the system which controls and implements the development of financial standards (United States 1977a, p.38).

The study was “centered on improving the auditing and financial reporting of large publicly-owned corporations” (United States 1977a, p.4). Achieving a meaningful disclosure by corporations and adequate accounting practices were important to the Congress and for this reason a review of the accounting establishment was “long overdue” (United States 1976b, p.iv).

The study’s report comprised eleven chapters and included recommendations for the accounting profession as per the findings and chapter details. The focus of the chapters was on the operations and influences of the big eight accounting firms, the AICPA, the FASB, and the SEC on one another and their role in setting accounting standards. The two major findings of the study were in relation to the SEC delegation of

its public authority and responsibilities on accounting matters to private groups with obvious self-interests ... [as well as] lack of independence and ... dedication ... shown by the large accounting firms which perform the key function of independently certifying the financial information reported by major corporations to the public (United States 1976b, p.v).

The findings were related historically to the issue “that the public interest ... [had] not [been] well served by leaving the setting of accounting principles and auditing standards solely in the hands of the accounting profession” as was stated by Congressman Moss, a member of the House of Representatives for 26 years from 1953 (United States 1977a, p.15).

The study findings and recommendations were mainly agreed to by the smaller accounting firms such as Alexander Grant & Company. The AICPA instead argued that “there is a total lack of evidence that adoption of the recommendations in the staff study would remedy any of the alleged faults” (American Institute of Certified Public Accountants 1977, p.6) and the study showed “no relationship between the charges against the profession, its bodies, and the SEC, and the business failures and misleading financial statements mentioned” (American Institute of Certified Public Accountants 1977, p.12). It was believed by the AICPA that the cases and concerns that were mentioned in the staff study were “totally groundless” (American Institute of Certified Public Accountants 1977, p.2). As mentioned in the introduction chapter, the AICPA prepared a report in response to the recommendations and suggestions. In their opening section it was stated

[w]e believe that the record of the profession refutes the principal charges levelled at the Institute, the accounting profession, the Financial Accounting Standards Board and the Securities and Exchange Commission in the staff study and shows that such charges are not supported by the study (American Institute of Certified Public Accountants 1977, p.2).



The AICPA report emphasised “the substantial efforts” of the accounting profession in the past and the present in avoiding “repetitions of past problems, as well as [the need] to anticipate new problems” (American Institute of Certified Public Accountants 1977, p.2).

As will be detailed in this chapter, the Accounting Establishment study recommendations were not fully implemented by the accounting profession or the SEC. The AICPA concluded that the study findings had failed to recognise “the tremendous efforts ... made by the accounting profession to eliminate as far as humanly possible the causes of misleading financial statements” (United States 1977a, p.114). Such efforts were explained to be undertaken by the Auditing Standards Executive Committee<sup>25</sup> by strengthening auditing standards and clarification of auditors responsibilities (United States 1977a, p.115). A remarkable fact is that the Auditing Standards Executive Committee was controlled entirely by the AICPA while the FASB had nothing to do with auditing standards. Accordingly, as will be explained in chapter seven, due to corporate failures and fraud, in 1983 hearings were held regarding similar issues with the accounting profession and the staff study was praised as being “the most meaningful and complete report ever published with respect to the practice of public accounting” (United States 1985, Part 1, p.724).

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<sup>25</sup> This Committee was in charge of establishing auditing standards.

## 3.1 The Accounting Establishment Study's Findings

### 3.1.1 SEC's Power in Setting Standards

The first finding of the study related to the SEC distancing itself from the “extensive power given ... by congress” and transferring its power of developing accounting and auditing standards to the private sector (United States 1976b, p.175). The Metcalf study pointed out that the public suffering from economic losses as a result of corporations reporting financial information which was “false and misleading” (United States 1976b, p.176), was related to the SEC failure to exercise its power and reliance on the private sector in establishing accounting standards. The SEC position was viewed to be protecting “the privileged position of the AICPA and its standard-setting bodies, rather than to protect the public from improper accounting practices” (United States 1976b, p.175).

The shift in power to the private sector, had led the SEC to avoid “making difficult decisions on developing accounting standards in the public interest” (United States 1976b, p.109). The SEC had only retained its “direct initiative in accounting and auditing standard rulemaking for only 27 months ... from its inception in October, 1934” and had never “tried to regain its authorities”, even though it was not approved by the Congress (United States 1985, Part 1, p.20). The reason was that the SEC, in a majority of cases, had taken the position “toward ambiguity” (United States 1985, Part 1, p.21). This was because of the “constant level of recalcitrance and hostility” the practicing accountants had towards the commission, which would lead to the SEC not always specifying “what had to be disclosed, and how”, while putting “the

responsibility upon the reporting group to disclose whatever was material” (United States 1985, Part 1, p.21). The FASB at the same time was not achieving anything significant. From its inception, the FASB avoided development of more controversial issues and “comprehensive accounting approach as well as uniform accounting principles, preferring the ad hocism long established” (United States 1985, Part 1, p.69).

Instead the AICPA had become “the authoritative source on accounting [and auditing] standards within the private sector” (United States 1976b, p.156). For the AICPA to keep the SEC enrolled in its network it was important to keep the relationship between them tight, by having the SEC Commissioners heading the AICPA study groups or becoming members of the AICPA (United States 1976b; United States 1977a). The AICPA was “careful to protect its enviable relationship with the SEC” (United States 1976b, p.109) as the close relationship meant development of “similar perspectives, sympathies, and understandings” (United States 1977a, p.22). This close relationship implied a similar relationship between the SEC and the FASB which was “controlled by the Big Eight and other large national accounting firms” (United States 1976b, p.174). It was “the revolving door between regulatory agencies and the firms they regulate” (United States 1977a, p.18).

This endorsement for the AICPA meant “the stamp of Federal Government approval” and the standards they set were “accepted as authoritative ... because of the expertise and impartiality which have been associated with the image of the accounting profession and its institutions” (United States 1976b, p.156). The system in place, for setting standards, was approved by the AICPA, as neither the public, investors nor the

SEC members had complained about this cosy relationship (United States 1977a). The chairman of the AICPA board argued that the system was sound and was serving the public well and “holds the promise of functioning even better in the future” (United States 1977a, p.100).

The SEC had defended the shift of standard setting powers to the private sector, which was argued by the study to be adversely affecting the public. This was firstly because, the purpose of standards designed would not be to protect the public or investors as was claimed by the AICPA (United States 1976b, p.175). Secondly, since the SEC delegated setting auditing standards to the private sector, it had “no procedures designed to verify whether independent auditors ... [were] performing their duties properly” as well as periodic reviews of the “accuracy, competence, and thoroughness” of their work (United States 1976b, p.182). The SEC even had “opposed legislation which would have enabled the General Accounting Office (GAO) to verify the accuracy of independent audits for oil and gas companies” (United States 1976b, p.175).

Based on the findings of the study in relation to the standard for oil and gas companies, “the SEC joined with the FASB and the AICPA in lobbying the Congress to leave the establishment of such standards to the FASB” (United States 1976b, p.175). The SEC was more concerned the credibility of the FASB was not eroded or threatened by the actions of Congress in relation to this standard than the “failure of the FASB and its predecessors to establish proper [and uniform] accounting standards for oil and gas companies during the past 40 years” (United States 1976b, p.175). This represented the success of the profession’s network in enrolling and capturing of the SEC, even though

the FASB had stated as part of their 1974 annual report that it “has neither a mandate nor a motive to attempt to influence legislation” (Cited in United States 1976b, p.168). Until then, the FASB and its predecessor, the APB, due to influences by the accounting profession and corporations, had failed in their primary responsibility of establishing uniform accounting standards “which was the impetus for Congressional action” (United States 1976b, p.169).

In another instance, to show their respect for the accounting profession, the SEC “withdrew [their] proposed auditing standards” relating to clarifying auditors responsibilities in relation to larger corporations preparing more frequent financial reporting statements (United States 1976b, p.1444). The SEC reasoning was that the profession had “come up with satisfactory procedures of its own” (Olson 1982; United States 1976b, p.1444). In keeping the SEC enrolled in the network, the AICPA’s response to the SEC’s recommendation about “significant expansions of auditors’ responsibilities”, was to “be taken very seriously by the profession” (American Institute of Certified Public Accountants 1977, p.28). To overcome these problems, Congressman Moss suggested the establishment of a “framework for the setting of accounting principles and auditing standards” by the SEC that would force the profession “to issue pronouncements within this framework” (United States 1977a, p.15). His suggestions were to “blend the expertise” by retrieving SEC’s authority in acting “on its own initiative in appropriate circumstances” in reviewing the pronouncements that were adopted (United States 1977a, p.15).

Loomis, SEC commissioner, in a letter to the House of Representatives argued the SEC's direct involvement in establishing these standards would "undermine a long standing and successful policy of relying upon the private sector" (Cited in United States 1976b, p.1437). He continued to argue that the area was highly complex and required an extensive time frame and it required the FASB to take over. In this regard, the FASB took charge of the standards and it followed its normal procedures for establishing a committee consisting of "representatives from big oil, gas, and mining companies, their Big Eight auditors, and large institutional investors" to put together the standard (United States 1976b, p.170).

The FASB's reliance on the industry in providing expertise led to "an intense lobbying effort by the industry" (Cortese 2011, p.19). This was apparent from the review of the accounting establishment study that the standards established by the FASB from its formation were "following in the same direction as previous AICPA standard-setting bodies" (United States 1976b, p.170). The study recommended the SEC "reclaim its public regulatory authority" (United States 1977a, p.5), while the FASB chairman argued "[i]f the SEC rulemaking procedure were to be imposed on top of ... [their] due process, the FASB's effectiveness ... would be significantly challenged" (United States 1976b, p.169). The AICPA also argued that this recommendation was not sound as "governmental agency might be less effective, since it would not have as readily available the experience of the profession in identifying problem areas" (American Institute of Certified Public Accountants 1977, p.29).

### 3.1.2 Big Eight Professional Responsibilities

The focus of the second finding of the study was on the big eight accounting firms and their performance in discharging their professional responsibilities. These firms had extraordinary influence over corporations and the Government as excessive concentration existed among big eight firms in supplying auditing and accounting services. This was the result of an increase in “corporate mergers” and companies going public and a growing need for utilising larger accounting firms were rising (United States 1976b, p.7 and p.45). Elliott a former AICPA member, described the move towards the large accounting firms as being due to their attractive offering of “creative accounting” for their clients or providing an auditing opinion which was a “clean certificate” (United States 1977a, p.384). Their size had assisted them “in resisting enforcement” as well as creating an opportunity “to make informal contact with potential clients” (United States 1977a, p.720). They, in comparison to smaller firms, were the most influential groups in relation to controlling “virtually all aspects of accounting and auditing in the United States” (United States 1976b, p.25). This domination and power of the big eight accounting firms was refuted by the AICPA. The AICPA’s reasoning, that they wanted the public to believe in utilising big eight accounting firms, was that auditing a large international company required a large accounting firm to meet the needs and requirements of the auditing process (American Institute of Certified Public Accountants 1977; United States 1976b).

The CPAs associated with these large accounting firms, were treated less “harshly by the SEC” even though “their appearance of independence” was compromised in relation to their services to publicly-owned corporations (United States 1977a, p.7). Elliott

agreed with the argument, that “the big eight technically, seem[ed] to be immune to discipline” as he had never witnessed “a firm being brought to bar, being brought to book” (United States 1977a, p.374). He argued that at times the SEC had closed their eyes on the review of “some rather loose accounting” treatments by these firms which “no small firm could possibly manage” (United States 1977a, p.385). Even if there was a lawsuit in this regard, he claimed that “some little guy underneath ... [would be] thrown to the wolves, a senior accountant, a management accountant ...[and] get indicted and suspended, and the firm rolls on” (United States 1977a, p.374).

Figure 1 demonstrates the large accounting firms self-interest and domination in the accounting standard setting system which in return benefits them by enhancing “the value of their services to clients by permitting more flexibility in reporting financial results to the Federal Government and the public” (United States 1976b, p.19; United States 1977a). Also the figure explains that the accounting firm’s employees and the FASB were “drawn from the



Figure 1

same pool” as it would be irrational “to assume that independence takes place because of an occupational change” (United States 1977a, p.27). Senator Metcalf was concerned that the auditors had “lost sight of the fact that the public is their real client, as well as the ultimate source of accounting fees” (United States 1977a, p.7). A similar argument was made by the SEC’s Chief Commissioner in 1936 in accusing the accounting profession of being loyal to management rather than “their responsibilities to the



investors” (United States 1977a, p.69). Nevertheless, the AICPA felt that the accounting profession had “compiled an excellent record of public responsibility” and that their “concern for the public interest has never been stronger than” at this time (United States 1977a, p.103). Being the independent auditor of a large corporation in the U.S., they also had the power to “affect the Federal Government and its programs” (United States 1976b, p.48).

The accounting establishment study had found that the management advisory services by big eight firms were “the primary problem area regarding the services offered” (United States 1976b, p.50). As this duty requires auditors to be involved in the management information system which conflicts with their obligation to act independently in their dealings with their clients. The auditors were bound by the AICPA code of professional ethics when conducting management advisory services. This service indicated real independence did not exist as accounting firms were providing “both accounting and management advisory services”, putting them in the position of “possible temptation to bend the accounting and auditing services to validate or fulfil a promise or advice” (United States 1977a, p.26). This non-accounting management advisory service was encouraged by the AICPA, the large accounting firms’ clients as well as the auditing firms increasing their profits. Since from the early 1970s the audit market had become “largely saturated ... [and t]o compensate, the firms aggressively broadened the scale and scope of their consulting practices” (Zeff 2003b, p.271). Even though the Association of Consulting Management Engineers (ACME), which consisted of independent management consulting firms, had been mainly responsible for performing this services for the past 100 years (United States 1977a).

The large accounting firms with their “unique insider position” were successful in performing these services and even dominating this part of the profession (United States 1977a, p.696).

The study confirmed the loyalty of these firms was first “to managements of corporate clients who retain them and authorize payment of their fees” which could lead to the problem of performing “defective audits” (United States 1976b, p.68). However, the study findings on this subject were denied by the AICPA. Since there was “no evidence that the performance of these services ... [were] compromised [by] any auditor” or that their independence was impaired (United States 1977a, p.112). On the contrary, the services were argued to have assisted auditors “to learn more about the client, its internal controls, the quality of its ... operations, knowledge that is helpful to the performance of the audit function” (United States 1977a, p.112). The AICPA was certain that the accounting firms had “sophisticated systems” in place to insure their “compliance with standards of independence” that were “rigidly enforced” by the AICPA (American Institute of Certified Public Accountants 1977, p.29; United States 1977a, p.113), taking into account that “[i]ndependence essentially is a state of mind and not something that can be measured with precision” (American Institute of Certified Public Accountants 1977, p.29; United States 1977a, p.135).

### 3.2 Subcommittee on Reports, Accounting and Management

In April, May and June 1977 hearings were held in relation to the accounting establishment study, after it was completed and distributed to the public. The hearings

were described by the then AICPA chairman, Chetkovich, to be held “during a time period when the roles and the performance of all of our institutions are being questioned, probed and tested for their adequacy” (United States 1977a, p.98). The purpose of the hearings was to assure the financial reports of corporations, which were independently audited, were “accurately and meaningfully” incorporating accounting practices and reflecting the “substance of corporate activities” (United States 1977a, p.1). The system of self-policing by the accounting profession was considered to be facing serious deficiencies and had raised questions regarding its ability to continue into the future. It required reform in its auditing and accounting procedures and establishment of standards. As one of the senior partners in Price Waterhouse and Co, Biegler<sup>26</sup>, claimed

the problem is not with the auditing and accounting standards themselves, or with the methods by which they are established. Rather it is with the quality of performance in implementing them (United States 1977a, p.475).

One of the issues argued was the quality of the standards, not necessarily the quantity of them. The other issue was the lack of policies in place to independently monitor and review the quality of the work of auditors and accountants. The AICPA’s board chairman of the time claimed that the problem of “corporate failure and significant shareholder losses” was minimal in comparison to the total number of audits that were performed by the large accounting firms (United States 1977a, p.99), but failed to comprehend that auditor failure even by one accounting firm could lead to harming “the entire profession” (United States 1977a, p.476) and losing its reputation which is its “most important asset” (United States 1977a, p.471).

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<sup>26</sup> Also at the time was the president of the FAF, which had the authority to appoint the FASB members.

In general, this reform by the private sector, supposedly was the solution to problems that had surfaced “because they could no longer be suppressed” and had “created a crisis of credibility ... in the private sector” (United States 1977a, p.13). However, Professor Chatov argued that the reform was not achievable as the problem was by far “broader than just the accounting and auditing rules developed by the selected private institutions” and was related to deficiencies in “the operation of the regulatory commissions”, the SEC, for instance (United States 1977a, p.22). His reasoning was that the SEC had been working closely with the AICPA “in an interactive network to achieve consensus on matters that are of most importance to the network” (United States 1977a, p.22). This consensus would only be achievable as long as the SEC did not “perform the responsibilities that were assigned to it in the area of corporate financial reporting under the 1933 and 1934 Securities Act” and avoided conflicts in the network (United States 1977a, p.22).

Congressmen Moss and Metcalf, also agreed that there was a need to restore the authority of the Government over the SEC which was mischaracterised by the accounting profession “as a Federal takeover of authority from the private sector” (United States 1977a, p.23). For example, the AICPA recognised the staff study recommendations were “imposing a vast new scheme of federal regulation on the accounting profession” which was unnecessary (United States 1977a, p.115). The recommendations were seen to “impede, if not destroy” the most extensive and vigorous efforts of the profession since it assumed the standard setting responsibility (United States 1977a, p.118). Biegler however, had recognised the restoration of power to the SEC in the area of monitoring auditors’ duties was an appropriate way to prevent future

problems rather than the current system that was based on responding to problems after their occurrence. He believed that federal legislation was required to establish “a new system ... [with] an appropriate regulatory framework to strengthen and monitor the quality of work performed by independent auditors” (United States 1977a, p.620).

Nevertheless, there was a need to bring in the government authority and partially, a change in the SEC structure. The SEC was to have “a leadership role” in making rules, rather than to be seen as the FASB’s staff function (United States 1977a, p.26). The SEC’s confirmation of the FASB authority implied that it would never

take over a leadership role, that there ... [would be] little reason to believe the FASB leadership ... to follow any pattern of behaviour other than those followed by its predecessor organizations [which is] ... to develop financial standards on an ad hoc basis without any focus on creating uniformity (United States 1977a, p.26).

One of the reasons, as stated before, for this behaviour was the AICPA’s substantial control over the

appointments to the FASB ... [so] that the people on the FASB are totally unconscious, unconcerned, and insensitive to the needs of the industry, other than the large national and international corporations who happen to be public (United States 1977a, p.373).

The other reason was the influence of the corporations and large accounting firms who were cooperating with the AICPA in policymaking. This view was not agreed to by Armstrong, the then FASB chairman, stating that the board was “the most effective and most promising vehicle to advance accounting standards necessary to maintain and enhance the strength of the capital markets” (United States 1977a, p.175). He testified at the hearings

to set the record straight with respect to many of the allegations made in the staff study concerning the lack of progress by the FASB and the lack of ... [their] ability to eliminate the accounting alternatives (United States 1977a, p.333).

On this matter, Senator Metcalf was disappointed with the way the FASB's then chairman had testified in the hearings and argued that it was "a self-serving declaration" (United States 1977a, p.333), as it had defended "the inactivity, the incompetence, the ineptness" of the accounting profession in establishing accounting standards and had rejected the recommendations made by the staff study (United States 1977a, p.333).

#### **4. Conclusion**

The accounting profession's struggle to keep the power of standard setting in house and out of reach of the Government has been apparent in history. The profession has tried to establish its ability to fully protect the public in its "reliance on audited financial statements" (American Institute of Certified Public Accountants 1977, p.40). The criticisms of the profession that resurfaced in 1983 and related hearings were held between 1983 to 1986, did not assist the accounting profession in maintaining its power over the standard setting process. Senator Metcalf's Committee study and hearings were aimed at improving the credibility of audited financial reports, by analyzing the role of the accounting profession, mainly as standard setters and independent auditors.

The reported findings of this committee, while supported by Senators and academics such as Chatov, were criticised by the accounting profession, namely the AICPA. The AICPA argued that the "adoption of the recommendations ... would, in truth, hinder" and frustrate any achievement of protecting the public (American Institute of Certified

Public Accountants 1977, p.40). Since, “imposing a vast new scheme of federal regulation on the accounting profession is unnecessary” (American Institute of Certified Public Accountants 1977, p.7).

While the accounting profession was occupied with responding to the study’s recommendations, the Congress was dominated by enactment of legislation to put a halt to bribery and illicit payments. The SEC arguably, was the only governmental agency to be seen actively investigating the illegal payments made by corporations registered with the SEC, as briefly explained in the previous chapter. However, the SEC’s lack of resources and funding meant that the investigations, which were partly undertaken by the corporations’ management and the assistance of their independent auditors, were neither sufficient nor thorough. Chapter two also demonstrated the SEC’s hope for these investigations to be leading to changes in corporate behaviour and corporate governance systems. The following chapters reveal the efforts of Congress and the SEC in combating illicit payments while demonstrating passive involvement of the accounting profession.

# Section II

The previous two sections detail the political events that led to the formulation of legislation condemning corruption and bribery. Section III aims at demonstrating that not only was the enactment of the FCPA controversial, but so too were the enforcement.



# Chapter Four: Hear No Evil, See No Evil

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*The heart of the problem ultimately is not economic but political. It is a problem of power ... where an institution that is able to skate above national regulations to work within the cracks between the laws of different countries is really accountable ... in our system. The global corporation has become ... the principal planners for our society and increasingly for other societies. The source of power is the control of capital ... becoming concentrated in fewer and fewer hands. The problem ... is ... where our political institutions, our laws, our tax laws ... our disclosure clause, have kept pace with the revolutionary changes in the world economy.*

*(Richard Barnett testimony in United States 1973a, Part 12, p.60-61).*

As demonstrated in Chapter two, the Ervin Committee helped greatly in investigating the Watergate Scandal that eventually led to the detection of American corporations' corrupt behaviour and illegal contributions. A brief summary of corporations' wrongdoings was presented in chapter two to show the incentive for further investigation by other congressional committees as well as the accounting profession and accounting bodies. The Ervin Committee as the initial hearing in this regard shed light on the problem at hand, the illicit payments and the lack of disclosure of the payments. The problem was employed by the principal actors of the networks that will be extensively explained in this chapter, to create their network as well as enrolling actors to their network. Stephen Solarz, Robert Eckhardt, Senators Frank Church and William Proxmire, were leaders and proponents, in the mid-1970's, in holding congressional investigations about various foreign corporate payments. The SEC, Congressman Moss and Senator Proxmire were the dominant actors questioning the

adequacy of the independent auditor's reports and function in revealing the questionable payments. The end result of these widely held hearings and investigations was the enactment of the Foreign Corrupt Practices Act (FCPA) that was signed by President Carter in December 1977.

The committees led by Church and Proxmire were the major ones that came to a general consensus of a need for new legislation to end corrupt practices and falsification of financial records (Dardess 1979). New legislation was perceived by these two Senators as the solution to the problem initially identified by the Ervin Committee and partly by the SEC voluntary disclosure program. During their hearings, primary actors, as defined by ANT, such as Church and Proxmire had created their own networks to persuade other members of Congress that their proposed bill/solution was the best way forward. The following sections will demonstrate the efforts of Senators, Congressmen and regulatory bodies' in the hope of establishing legislation to fight foreign corruption as well as the networks that were created and re-created respectively. The chapter is structured on the timeline of the creation of congressional hearings from 1972 up to 1977.

## **1. Senator Frank Church Actor-Network**

Senator Frank Church, of Idaho, as a member of the Democrat Party became, at the age of 32, one of the youngest ever Senate members. Church was “known for his flowery speeches and heartfelt morality” (Olmsted 1996, p.53). He was described by Newsweek as “one of the most articulate and insistent proponents of the ‘new morality’ that has

dominated American politics since Watergate” (cited in Ashby & Gramer 1994, p.466). In 1965, he began to criticize the United States’ involvement in the Vietnam War, and by the 1970s initiated the investigations of multinational corporations, and creation of his network, in relation to foreign bribery in spite of doubts amongst his colleagues about his success in investigating bribery cases (Ashby & Gramer 1994).

As “a strong advocate for fighting international corruption” (Biegelman & Biegelman 2010, p.10), Church as the principal actor of his network, revealed a pattern of disregarding law at corporate and U.S. government levels which ultimately led to a president resigning “rather than risk impeachment” (Ashby & Gramer 1994, p.466). These investigations led Church to head inquiries into intelligence bodies, the CIA and FBI, in order to make “the secret agencies more accountable” (Olmsted 1996, p.55). The hearings were held by the Senate since during this time period, the House of Representatives “was more divided, [and] more partisan” in comparison to the Senate (Olmsted 1996, p.56).

The above investigations and subcommittee hearings assisted Church to enroll actors to his network and mobilise his network. The hearings

marked some of Church’s finest hours. They fused in compelling ways his views on foreign policy and civil liberties ... [as] he dealt with issues that cut to the heart of American democracy, asking who, or what, ruled America (Ashby & Gramer 1994, p.491).

Senator Church ran for presidential candidate pre-selection in 1976 with an emphasis on “his role as investigator of the secret government” (Olmsted 1996, p.55) which had

exposed the public to information about “institutions that had never been challenged before” (Olmsted 1996, p.103). He campaigned for Democrat presidential nomination but was defeated by Jimmy Carter<sup>27</sup>. Subsequently, in 1979, he chaired the Foreign Relations Committee after the retirement of the previous chairman. His passion for becoming the U.S. president had led to Church abandoning his network, and a turn in his goal and focus of establishment of new legislation to curb corruption. The ANT will be used throughout the following sections to demonstrate the process by which Church created a network during his hearings on Multinational Corporations that was ultimately defeated. More importantly, the bill that was born from these hearings was left idle and was defeated by other networks. The following sections and next chapter will explain the details of the networks, hearings and the bill proposed by Senator Church.

### 1.1 The Subcommittee on Multinational Corporations

In 1972 Church became the Chairman of the Subcommittee on Multinational Corporations, a multi-year inquiry originally convened to run to 1976 and then converted into a Subcommittee on International Economic Policy (Broad 2002). The Subcommittee known as the Church Subcommittee, was the network that Senator Church had successfully created and it had become “[o]ne of the long-standing investigative committees of the congress” (Broehl 1998, p.299). It was formed as part of the Senate Committee on Foreign Relations. A majority of its members, the actors of the network, was chosen based on their business backgrounds to avoid “charges of being anti-corporation” (Ashby & Gramer 1994, p.418). Senator Church, as the

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<sup>27</sup> Senator Church in Washington announced his withdrawal from the presidency race.

principal actor, was “all hot to go after ... multinational corporations”, and was “willing to chair hearings on this subject” (Cited in Ashby & Gramer 1994, p.419).

For Church, “the investigations offered a splendid opportunity to combine moral convictions with personal advantage” in bringing him “substantial national exposure” by effectively chairing this committee (Ashby & Gramer 1994, p.423). He wanted to enrol other actors outside his network and interest them in the problem that had surfaced from the Ervin Committee hearings. His argument for holding these hearings and the aim of his network was that the

basic tenet of our democracy is that the people must be told of the mistakes of their government so that they may have the opportunity to correct them. We believe that foreign people will, upon sober reflection, admire our nation more for keeping faith with our democratic ideals than they will condemn us for the misconduct itself (Church 1985, p.104-105).

The subcommittee was initially established to investigate allegations that International Telephone and Telegraph (ITT) offered money to the CIA to influence and manipulate the Chilean presidential election in 1970 (Jain 2001; Johnson 2006; Olmsted 1996; Solomon & Linville 1975). The ITT case was the obligatory passage point for the Church network to assure the validity of its existence and success. The CIA, as an outside actor, had previously made efforts to shift the inquiries to a committee where detailed questioning and investigations were not part of the agenda (Johnson 2006).

The subcommittee’s findings from these investigations “were explosive” and led to “investigations in the Netherlands and Italy and led to the arrest of a former Japanese prime minister” (Olmsted 1996, p.54). The ITT case helped Church to enroll corporate

wrongdoing as a non-human actor and to recruit other actors. However, the political reactions in the U.S. were different as the outside actors such as the then United States ambassador to Costa Rica, Viron Peter Vack, claimed the investigations “just stirred things up but I do not think it was taken seriously. It was not taken seriously by Henry [Kissinger]. It just fed people’s anxieties” (cited in Gustafson 2007, p.199). The corporate executives even warned Church concerning the effect of investigations on their businesses abroad and “subvert[ing] U.S. interests abroad” (Ashby & Gramer 1994, p.419).

As the subcommittee was coming to its conclusions about ITT, the Watergate investigations brought to the surface the questionable payments by a variety of multinational corporations such as Lockheed, Northrop Corporation, Exxon Corporation, and Gulf Oil. The issue of illicit payments became substantial as it was “not just ... a little baksheesh to grease the palm of some petty clerk in order to speed needed documents on their way through the bureaucratic labyrinth” (United States 1975d, p.7). Accordingly the subcommittee expanded its investigation revealing the significance and growth of questionable payments in the 1960s and early 1970s (Jain 2001). The illicit payment cases were enrolled as the non-human actors, which helped this newly established network to strengthen its existence. By enrolling these actors, Senator Church was able to demonstrate his central role in this network. So, it can be said that by this time the network had passed through the interessement moment of the translation model.

The subcommittee “had put its finger on a whole series of shady practices, just about all of which had turned out to be both accurate and needing amelioration by some form of congressional action” (Broehl 1998, p.300). It “publicized investigations of relationships between U.S.-based multinational corporations and American foreign policy, illuminated shocking corruption and the arrogant misuse of power” (Ashby & Gramer 1994, p.415). The inquiries resulted in “seventeen riveting volumes that offer[ed] a more thorough examination of corporate practices overseas than any other inquiry of this ... era” (Broad 2002, p.71). The subcommittee exposed payments to foreign governments made by U.S. international companies such as Gulf Oil Corporation, Northrop Corporation, Exxon Corporation, Mobil Oil Corporation and Lockheed. It became apparent “[i]n the course of the Watergate Committee hearings and the investigation by the Special Prosecutor, ... that major American corporations had made illegal political contributions in the United States” (United States 1973a, Part 12, p.1) and abroad.

From the documents and information that the subcommittee evidenced, it seemed to Church that the United States was “on a treadmill with no end in sight. It is time for us and our allies to stop and consider what it is that we are doing and to what end” (United States 1973a, Part 12, p.108). The hearings and the network created by Senator Church were deemed necessary because it was “time for plain speaking” on foreign bribery and corruption (United States 1973a, Part 12, p.239). Palazzolo (2012) indicated that Senator Church “believed U.S. companies were undermining the nation's Cold War-era foreign policy, tarnishing free enterprise by sowing corruption among U.S. allies” and the seeds of new wars (United States 1973a, Part 12, p.108). Corruption was “[a] cancer

... eating away at the vitals of Western society” and that one would be able to “no longer pretend that this is purely a matter of personal or corporate morality” (United States 1973a, Part 12, p.239).

The subcommittee inquired into multinational corporations promoting their sales overseas by channeling “money to foreign government officials through large agents’ fees or direct political contributions” (United States 1973a, Part 12, p.341). These hearings on foreign bribery were held in the hope of forming clear legislation or guidelines having the force of law, domestically and internationally, with help from multinational companies testifying to this subcommittee. This was also the ultimate goal of the network, it was the proposed solution to the problem of illicit contribution payments. However, from past experience, “the effectiveness of governmental regulation has not been very reassuring” and over time it is apparent “regulating agencies are taken over by the very industries they attempt to regulate” (United States 1973a, Part 12, p.97).

It was argued by corporations, that if a law existed to prohibit bribery and corrupt payments, these companies would have resisted the demand for illicit payments. From the point of view of Senator Church, it was “no longer sufficient to simply sigh and say that is the way business is done” (United States 1973a, Part 12, p.2). Such a stance would only perpetuate the illicit payments. Hence it was necessary to treat bribery as a “serious foreign policy problem” (United States 1973a, Part 12, p.2). The rationale behind this way of doing business was explained by Senator Biden as “the American



way ... [and i]f it interferes with what the law says, and what our concept of morality is supposed to be, well, that is just the price of doing business” (United States 1973a, Part 12, p.378). Even though corruption and bribery were and continued to be “present and institutionalized in many of the countries with whom” U.S. multinational companies dealt (United States 1973a, Part 12, p.15), Senator Church argued “[t]he notion that American companies must do it because foreign companies do it, seems ... to be not only morally wrong but exceedingly shortsighted” (United States 1973a, Part 12, p.344). By taking corrective measures “it can hopefully prevent perpetual enslavement to a system that thrives on secrecy and darkness” (United States 1973a, Part 12, p.15).

A common view amongst Senators and actors of Church’s network was the need for enactment of new legislation or a code of conduct dealing with illicit payments. The network was at the mobilisation moment as the actors had become spokespeople for the network and supported the proposed solution. However, having new legislation even though it would help to eliminate the illegal payments to domestic and international political parties, was not perceived to be assurance of enforcement of the law. Senator Church observed the problem of “corporate lawlessness” stemmed from the “disrespect for law” that was apparent in the highest levels of U.S. Government (Ashby & Gramer 1994, p.466). In 1976 Professor Ratner<sup>28</sup>, from Cornell Law School, expressed agreement with this view stating before the Corporate Rights and Responsibilities hearings, that the issue was with the enforcement of existing laws and would be the same with new ones (United States 1976f). The problem was not with having a law in place but

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<sup>28</sup> Professor Ratner testified at the ‘Corporate Rights and Responsibilities’ hearings held by the Senate Committee on Commerce on June 23, 1976.

the moral fiber of any Organization ... [which] embraces corporate compliance. ... 'The top guy has to set the ethical standards' and without that support, no number of codes of conduct or laws will work (Biegelman & Biegelman 2010, p.13; N.A 1976).

### 1.1.1 Pre-existing Illicit Payment Laws

At the same time as the bribes and illegal payments were made, the U.S. and many other countries such as Korea, France and Germany already had laws in place that prohibited these payments. The pre-existing laws served as a foundation for the problematisation process instigated by Church and others including Proxmire, as will be explained in the following sections, leading to the FCPA. These laws were knowingly violated by the American corporations. This can be illustrated by the fact that in the U.S., for example The Corrupt Practices Act of 1907 prohibited political contributions by corporations to federal political campaigns (Greanias & Windsor 1982).

The act was described in the 1971 Senate committee report as “worse than having no law regulating Federal elections” (United States 1971, p.114). It was full of loopholes, lacked enforcement, and had provided “neither the candidates nor the public with any guidance or information concerning the election process” (United States 1971, p.114). The law was described as having created “an illusion of regulation” providing for “an easy excuse for preserving the status quo” (United States 1971, p.115). The failure of such laws and policies in the U.S. were described by Church to be a consequence of

pure tokenism ... - once in a while somebody will bring a token case - obviously the policy has failed because giantism is the name of the game .... There must be a much more effective way to restore and revitalize the free market, to cope with this oligopoly that is developing (United States 1973a, Part 12, p.81).

Accordingly, the enforcement of the act “by both the federal and state authorities until the Watergate prosecutions ... [, was] practically non-existent” (McCloy et al. 1976, p.3).

With respect to American companies selling arms abroad, the Arms Export Control Act of 1975 was amended to include sections in relation to public disclosure of the agents’ fees, commissions, political contributions and gifts which were resisted by the corporations (Dardess 1979). As part of the opening statement of the Lockheed Aircraft Corporation hearings, as will be discussed later in this chapter, Senator Church stated,

It would be the height of irresponsibility for the Congress at this time to give in to the tremendous lobbying campaign that is now being waged by the corporations against legislation to control arms exports and foreign agents’ fees and to adapt the present administration’s attitude of “see no evil, hear no evil” (United States 1973a, Part 14, p.2).

From the hearings held by the subcommittee, it became clear that enforcement of a law was not the only concern. The other issue was that the Government not only encouraged but educated corporations in making illicit payments abroad. For instance, the Departments of State and Defense had

given some companies the impression that it is willing to tolerate the use and misuse of agents’ fees so long as growing arms exports continue to contribute to a more favorable balance of payments for the United States (United States 1975d, p.8).

Senator Clark likewise was mainly concerned with the companies’ application and enforcement of the law by questioning “[w]hat would one more law mean to you ... why one more law would be more effective than the laws that are already on the books”

(United States 1973a, Part 12, p.34). Few corporate leaders have condoned corrupt practices “as a necessary feature of their operations in certain parts of the world” (United States 1976i, p.39) by making excuses that the payments are counted as being a normal part of doing business and are an “established part of the economic and social system in many countries” (United States 1976i, p.39). The excuses from Church’s viewpoint were doubtful as corporations had used “off-the books accounts, Swiss bank accounts, dummy or shell corporations set up in Switzerland or Lichtenstein, numerous agents or intermediaries, whose existence ... [was] often kept secret” to conceal their conduct from auditors, boards of directors and shareholders (cited in United States 1977d, p.2).

### 1.1.2 Details of the Multinational Corporations’ Illicit Payments

In relation to multinational oil companies, the majority of their worldwide competition was among U.S. based oil companies. In addition, the chairman of the board of directors of Gulf Oil argued that after World War I, “oil companies were encouraged” by the government to go international and “to get ... [their] stake in the Middle East”, but they were left on their own “like motherless children” in regards to their dealings and investments (United States 1973a, Part 12, p.27). International contracts, regardless of this matter, were attractive for the corporations as it was a way of increasing their income and profit by paying the price of bribery. For Gulf Oil Corporation for example, the pressure to pay bribes was greater when the company was deeply involved in contracts and the amount of investment in foreign countries was greater (United States 1973a, Part 12). It was argued by the company’s chairman that these illicit payments had to be paid to preserve the investments that were assumed by him to be in the best

interest of the company, its shareholders as well as the public (United States 1973a, Part 12).

However, these payments were made without the knowledge of the company's board of directors and through subsidiary companies, recorded as advances to these subsidiaries and miscellaneous expenses by the subsidiaries to conceal the actual use of the money<sup>29</sup>. As the amounts of expenses recorded were not material in comparison to the contract amounts, it was never questioned even though "it was a matter of national interest" to the U.S. Government and people (United States 1973a, Part 12, p.25). This pattern of falsification of records and books of the company was apparent in other multinational companies such as Exxon Corporation, Northrop Corporation and Mobil Oil Corporation. Thus, the accountability of the multinational corporations to society was violated.

At the same time, the board of directors, as the governing body in charge of the management of the affairs of the corporations, had breached their financial reporting responsibility and stewardship to the stakeholders. Corporations' lack of social responsibility, as the non-human actor, had become one of the main concerns of the Church network and was enrolled as part of the actor-network. Corporate morality, too, as another non-human actor was recruited. Accordingly, the subcommittee dedicated the majority of its time inquiring and questioning people representing the Government and Multinational Corporations, to make certain of the soundness of the network. The following sections detail the findings of the subcommittee, how the Church network

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<sup>29</sup> As briefly explained in chapter two.

based on ANT, was able to continue its existence and finally put their proposed legislation before Congress.

### 1.1.3 Examples of Falsification of Financial Reports

Mobil Oil Corporation had recorded the political contributions as either advertising expense or research depending on the invoices received by their branch in Italy or at the request of political parties in Italy. Mobil Oil claimed that this procedure was the custom that was followed in Italy. The board of directors was not informed of the political contributions that were made in Italy due to lack of internal controls (United States 1973a). The board was not advised, even though the political payments were not part of the general operations of the company. The same pattern was found in the case of Exxon.

At Exxon, political payments were recorded as administrative and marketing expenses. The board of directors and some managers were not advised of political payments, even though these payments involved large sums of money and were not “typical of the general pattern of operation” in Exxon (United States 1973a, Part 12, p.247). Failure to inform the board was justified by Exxon controller, Monroe, by the fact that political contributions were legal and lawful in Italy. However, these payments were not recorded in the company’s books and were disguised using “dummy invoices to indicate payment for services not actually rendered; overbilling customers” (United States 1973a, Part 12, p.248). This pattern was used by an Exxon subsidiary in Italy which was not questioned by the company’s management as it was “the customary way” of doing

business in Italy (United States 1973a, Part 12, p.248). Exxon auditors knew of the accounting treatment and expressed “concern about lack of management controls ... yet nothing was done about this” until the Watergate hearings and questioning by the SEC had commenced (United States 1973a, Part 12, p.252).

Northrop Corporation bribery payments were mainly made to agents, consultants and business partners. These individuals were described by the committee as “shadowy figures operating behind the scenes whose activities [were] ... vaguely alluded to but never explicitly stated ... a cast of characters out of a novel of international intrigue” (United States 1973a, Part 12, p.107). As the company did not want to know how the business was performing and to whom the products were sold by its international branches. According to the committee’s findings, the payments were documented by Northrop “in a way that would permit the company to disclaim knowledge or responsibility for the uses to which it was put” (United States 1973a, Part 12, p.107). Accordingly, these payments were assumed by the board of directors or the executive committee to be the standard procedure and the best practice and it was not questioned. The use of consultants or agents that were doing the business on behalf of the corporation required a creative mind to be able to conceal the nature of the transactions overseas. The creativity as debated by Senator Percy, “in the name of greed can concoct schemes faster than we can get legislation against them ... [and] this was invented long before we started doing major overseas business” (United States 1973a, Part 12, p.119).

The Northrop Corporation, Exxon Corporation and Mobil Oil Corporation cases were not only about corporate morality. The Northrop case was also about the Pentagon, and U.S. Government involvement and their lack of attention to detail. As in the 1960s the company had entered into “Pentagon-sponsored export sales” securing them huge profits (Ashby & Gramer 1994, p.459). Under the foreign military sales program<sup>30</sup>, the Defense Department’s duty was to approve all of the weapon manufacturer’s expenses including any commission fees. However these fees were never questioned by the Defense Department until the 1970s when the Watergate investigations surfaced.

Northrop Corporation in return provided the Defense Department with entertainment services for their officials. From the point of view of Senator Church these commission fees were linked to the contract amounts. Specifically, there was a tendency to inflate the contract amounts, so there would be “an unprincipled race to arm to the teeth the newly rich nations of the Persian Gulf” which could “end up corrupting ourselves and those who deal with us” (United States 1973a, Part 12, p.108). In relation to the Exxon Corporation and Mobil Oil Corporation cases, each was paying political contributions to favourably affect the Italian legislation dealing with oil companies. Senator Church argued that the U.S. Government including the State Department was implicated in these dealings. The payments were also used to fund the election campaign of Italy’s different political parties, mainly the major non-communist Italian parties. Also, to curb the advancement of communism and the Communist party. However, when Exxon wanted to come clean and reported these payments to high U.S. Embassy officials in

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<sup>30</sup> The U.S. Defense Department through the Foreign Military Sales (FMS) program facilitates sales of U.S. defense articles and services such as arms, and military training to foreign governments and international organizations when the President formally finds that to do so will strengthen the security of the U.S. and promote world peace (<http://www.dsca.mil/foreign-military-sales-fms>).



Italy, the reaction by the U.S. officials was “that’s a nice slice of pie they’re getting” (Cited in United States 1973a, Part 12, p.240).

The Lockheed scandals came to the subcommittee’s attention during their Northrop investigation and the discovery of documents that referenced Lockheed. The subcommittee was able to secure “masses of documents from Lockheed’s auditors before the company could intervene” (Ashby & Gramer 1994, p.461). Investigations by the subcommittee revealed significant involvement of “more than thirty countries, spread across four continents” as part of the questionable payments which were referred to by Newsweek as “Great Global Fall” (cited in Ashby & Gramer 1994, p.465). The Lockheed scandal, as a non-human actor enrolled in the Church network, was quite distinct from the previous cases discussed above. First, it was “a company that [lived] only by the grace of Congress”<sup>31</sup> and was the recipient of government loans under the Loan Guarantee Act (United States 1973a, Part 12, p.344). Second, the U.S. was “the single largest arms exporter in the world” (United States 1973a, Part 12, p.341). Thus, the survival of Lockheed was in the national interest and for this reason, “the President brought all the force and pressure [necessary]... to keep the company going” (United States 1973a, Part 12, p.361).

The scandal revealed immediate benefits Lockheed had gained were in effect “contrary to America’s long-term interests. ... demonstrat[ing] how easily corruption, hidden behind a curtain of national security, could infect America’s own government” (Ashby & Gramer 1994, p.460). Lockheed’s corrupt sales were supported by the U.S. embassies

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<sup>31</sup> The company’s attorney was Nixon’s Secretary of State (Ashby & Gramer 1994, p.463).

abroad and the State Department even though it influenced and subverted U.S. Government military sales' objectives abroad (United States 1973a, Part 12). Lockheed

had used an off-the-books account to buy business intelligence and pay the officials of major European airline consortia ... in Italy, thus providing the Italian Communist Party with its strongest election issue, corruption; and ... its agent, a prominent leader of the ultra right wing militarist political faction in Japan ... has paid him[, Lockheed agent,] millions of dollars in fees and commissions over the last few years (United States 1973a, Part 14, p.1).

As with the Northrop case, Lockheed hired foreign agents and consultants to promote their sales abroad. Lockheed's reliance on agents was joked by Strauss, West Germany's Defense Minister, as the company having "salesmen ... everywhere. I can't open a drawer in my desk without a Lockheed man falls out of it" (cited in Ashby & Gramer 1994, p.462). These agents were hired mainly based on their "connections in influential Government circles" rather than on their "local expertise or ... technical knowledge" (United States 1973a, Part 12, p.342). The agents were paid huge fees which were recorded as cost of sales in Lockheed's books and records which would have significantly inflated the price of the military weapons sold to the governments.

From Senator Biden's point of view this way of record keeping had "financial advantage domestically" for Lockheed, and was "directly cheating the American taxpayers" by recognising less tax revenue "to maintain the same service" (United States 1973a, Part 12, p.379). In relation to their sales in Japan, as stated by the auditors, the corporate funds were transferred to another bank or trust account to be transferred to the agent. The funds were recorded as a payment to a marketing consultant and shown on the balance sheet as prepaid marketing expense (United States 1973a, Part 14, p.313). Lockheed was using "the U.S. Government ... [at] its convenience and

undermin[ing] U.S. policy”, regardless of the quality of the policy, “when it ... [was] convenient from the point of view of promoting sales” abroad (United States 1973a, Part 12, p.386).

#### *1.1.3.1 Strengthening the Actor-Network*

In Senator Church’s opinion, the problem of bribes and payoffs would have adverse effects on the economic and political situation of the U.S and other countries. His point of view was consistent with the aim of the previous hearings held by him in relation to the intelligence bodies for instance and his strong advocacy and speeches for morality dominating after the Watergate scandal and revelation of corrupt and questionable payments. From his perspective, the arguments put forward by Church reflected a genuine stance rather than political posturing. As such, his arguments presented during the hearings facilitated maintenance of the Church network.

His first viewpoint was that it would create unfair competition between companies, forcing ethical companies to be squeezed out of these foreign markets. Consequently, competition and getting “the most favored treatment” would be related to the amount of money that is slipped under the table (United States 1973a, Part 12, p.2). The reason being the foreign officials that are “looking for money are unconcerned about the quality of the product or service being offered” (United States 1973a, Part 12, p.2).

Secondly, illegal political contributions in other countries can influence the political party that would control a country. This was apparent in the Exxon Corporation case, resulting in the Italian communist party winning the election as they used corruption in the democratic party as a potent weapon using the slogan “[w]e are the only ones with clean hands” (cited in United States 1973a, Part 12, p.239). Senator Church argued the change in Italian electorate behaviour was because the “democratic government [was seen as] ... the servant, not of the people, but of large vested economic interests ... [f]undamental changes ... will then become inevitable” (United States 1973a, Part 12, p.240).

Thirdly, it may influence the way a country is going to spend their national income on the import of commodities and resources, and diversion from products that would be more beneficial to their people and the country (United States 1973a). For instance in the Lockheed case, it was maintained the bribes and kickbacks paid to Indonesian officials was to ensure the Government would purchase aircraft only from Lockheed which meant that national income was diverted from the purchase of products vital to the country’s growth and survival (United States 1973a). These “fat wads of money” would make the sales of military products more attractive as it would make the Government officials rich quicker (United States 1973a, Part 12, p.375). Bribery payments can also affect and persuade a country’s decision on the type of military commodities they require. They might be persuaded to buy advanced military weaponry that is not needed or that is “more advanced than they can use effectively” (United States 1976i, p.40). The next chapter will explain the outcome of the above

investigation and findings. It will also demonstrate the failure of the presumed Senator Church network in enacting new legislation as his network goal.

## **2. Senator William Proxmire Actor-Network**

Senator Proxmire, a Democrat from Wisconsin, served in the Senate for 32 years. He was known for his efforts to curb corruption and “irritated presidents and lawmakers from both parties because of his contempt for the mutual back-scratching most politicians engage in” (Severo 2005). During 1976, Senator Proxmire held a series of hearings before the subcommittee on Priorities and Economy in Government of the Joint Economic Committee. Based on the theory adopted by this study, the hearings can be viewed as Proxmire’s initiation in creating a network to investigate the problem of corrupt practices and defining identities and interests of other actors in establishing itself as indispensable to them. Proxmire’s network was solely related to the problem of illicit payments that had surfaced in the hearings held by the other Senators and the SEC’s voluntary disclosure program. In comparison, Senator Church’s network, as previously explained, predated the Watergate revelations to early 1970 inquiries which initially focused on the lack of CIA and FBI accountability. Church’s interest in examining foreign policy issues, led him to investigate the allegations of the ITT kickbacks to influence Chilean presidential elections and further on the other multinational corporations investigated by the Ervin Committee.

The initial hearings by Proxmire were held in January and March in 1976. These hearings were referred to as the ‘abuses of corporate power’. For Proxmire to attain

continued support from the public, and politicians, he held several other hearings as part of the subcommittee on Priorities and Economy in Government during 1976. The latter hearings were held in April 1976, titled ‘the foreign and corporate bribes’, and later on in May referred to as ‘prohibiting bribes to foreign officials’ hearings. The details of the hearings are explained later in this chapter. The purpose of the hearings and Proxmire’s network was to focus on corporations that had “wrongfully used their funds as a matter of policy, with the approval and active participation of top management” leading to a “loss of consumer confidence” (United States 1976a, p.1).

The impetus for these hearings originated from the previous hearings that were held in regards to the Watergate scandals, multinational corporations’ corporate crimes and Watergate Special Prosecutor’s convictions. Bribe payments to foreign officials were seen as a “disgrace of ... [the] free enterprise system ...[in] which the most efficient producers with the best products are supposed to prevail” (United States 1976i, p.1) but inferior products with higher cost were being traded. Ball<sup>32</sup> argued it “is asking too much of human credulity” to claim that the lifeblood of the system is based on competition, “while slipping money under the table to foreign purchasers” (United States 1976i, p.75). Free enterprise was a system that the U.S. prided itself on and touted its benefits to the public, however, its competitive success depended “not on market forces but the debauching of Government officials” (United States 1976i, p.41).

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<sup>32</sup> The former Under Secretary of State and senior partner of Lehman Bros.

## 2.1 Problematisation Moment of Proxmire's Network

Proxmire, as the principal actor, identified the problem to be first, the private sector's lack of ability to monitor itself. He argued "the private sector is a house of marked cards, composed of kings of corruption, jacks of all illicit trades, and aces of political influences" (United States 1976a, p.1). In this regard, Senator Proxmire questioned the SEC's reaction to companies' lack of keeping faithful books and records, as from his standpoint "the system hasn't worked so far. That is why we are in this difficulty" (United States 1976a, p.20). The system Proxmire was referring to was maintenance of books and records and corporations governing themselves by their independent audit committee communicating with external auditors.

The second problem was in relation to Government's lack of reaction towards international illegal and questionable payments. Senator Proxmire claimed that "[b]ribery flourishes in this kind of environment" (United States 1976a, p.112). An environment, as observed by Proxmire, where Government's high officials advise on paying "attention not to what Government officials say but rather to what they do" (United States 1976a, p.151), since the Government's statements were regarding their condemnation of bribery but the actions of their officials were contradictory. As argued before, the Government publicly denounced the payment of bribes but the Pentagon had been "tutoring its contractors on how to make foreign payoffs" (United States 1976a, p.112) in order to promote arms sales even if this meant "outrageously high sales commissions" and bribery payoffs (United States 1976a, p.151).

The Defense Department was also encouraging, directing and instructing “corporations on how to make these illegal payments” (United States 1976k, p.87). Lockheed was one of the corporations that was coordinated by the Pentagon and was also pushed by the Pentagon to “increase their sales of arms to foreign governments” (Proxmire 1976, p.2; United States 1975b). A former U.S. ambassador to Argentina and Cuba, Braden, testified at the “foreign and corporate bribes” hearing arguing the same point from his experiences with illicit payments. He had prevented U.S. corporations from being extorted by announcing his intolerance of corporations getting involved in these issues. In one instance he even requested a manager of a company to be fired when he found out that bribe payments were involved in their dealings abroad. The ambassador believed there was no need to pay bribes to perform business in another country. His policy also extended to the foreign Government by announcing his intolerance for this behaviour. From his point of view,

there must be complete acceptance of responsibility and self-discipline by the State Department, ... [U.S.] embassies and by private corporations and individuals operating in or dealing directly or indirectly with foreign affairs (United States 1976i, p.25).

### 2.1.1 Translinear Inc Case

The following case was presented during the March hearing that focused on the lack of Government and State Department attention to corporations who were under pressure from foreign Governments to make illicit payments. Proxmire stated that the Translinear case represented the consequence of honest and responsible business refusal of becoming “part of the bribery system” in an environment which foreign payoffs were encouraged (United States 1976a, p.111). The case can be said to help Proxmire to make the network indispensable and assure the vitality and success of his network’s



translation process. Translinear Inc was a corporation operating in Haiti, and was pressured by the officials' of the Haitian Government to pay bribes. Translinear had started a mutually beneficial project with Haiti to build "hotels, golf courses, tennis courts, [and] a beach" on an island (United States 1976a, p.182). During their construction they discovered water that was known to be economically valuable on the island. This discovery led to an alteration in the government's behaviour towards this project.

The corporation's officials were "threatened with the blockage of the contract" unless the requested payment was made (United States 1976a, p.140). When they contacted the U.S. Embassy for assistance and advice, no action was taken to protect or assist them in their negotiations "except offer[ing] them a cup of coffee" (United States 1976a, p.178). Non-responsiveness of the U.S. embassy was observed as meeting "with nothing but a blank wall" (United States 1976a, p.180). The reaction from the Haiti President was to restrict Translinear's operations and block their access to its equipment. The Haiti Government even changed a law that was relevant to Translinear's lease of land in Haiti. The State Department was also notified of the events that had taken place, and the reaction was similar to the U.S. Embassy. When the State Department representative was present at the following day's hearing, it was claimed their "responsibility [was] to assist American businessmen who are treated unfairly" (United States 1976a, p.153).

### 3. Initial Hearings and Their Outcomes

Relevant Government agencies such as the SEC, and the General Accounting Office (GAO) testified at the hearings. However, “no signs of activity by the FBI, Justice Department, or IRS” were apparent, and “the State Department’s actions ... [had] not been helpful” (United States 1976a, p.39). The absence of these bodies was the focal point of the January hearing. The GAO, in relation to this matter, argued that the bribe and kickback cases which had been referred to the Justice Department<sup>33</sup> were not prosecuted or even investigated further. Even though there was a possibility that Federal law such as the Anti-Kickback Act of 1934 was violated. This fact was apparent in cases the SEC had referred to the Justice Department at the time, but no criminal action had taken place.

The Justice Department played an important role as it had the investigatory responsibility and authority to prosecute the cases at hand. Ralph Nader<sup>34</sup>, a consumer advocate, claimed the Justice Department’s low priority and lack of attention to “corporate economic crimes or crimes involving Government-corporate relationships” was related to funding and allocation of their time. He said “the Justice Department ... [had] been expanding the huge bulk of its funds in the area of crime in the streets” and shying away from corporate crime cases as they were “extremely time consuming or complex” (United States 1976a, p.91). One of the cases that was under investigation by both the SEC and GAO was the Lockheed case which is briefly explained below.

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<sup>33</sup> Department of Justice is responsible for investigating violations of criminal laws

<sup>34</sup> Among his other accomplishments, he was “one of the most astute observers of corporate ethics and crime in the suites” (United States 1976i, p.3).

### 3.1 Lockheed Bribery Case

Some light was shed on the Lockheed case as part of the arguments earlier in the chapter dealing with the Subcommittee on Multinational Corporations held by Church. The case was quite distinct, as Lockheed's corrupt sales were supported by the U.S. Government and for this reason it was enrolled by Church as a non-human actor, to maintain and recruit new actors to his network. Following the subcommittee hearings and investigations of the Lockheed case, Senator Proxmire became interested in the case as well. Proxmire wanted to further his own and his network's political aspirations by using Church's successful case. As the case had helped Church to pass his network through phases of the translation model, Proxmire also wanted to initiate investigations in relation to the Lockheed case, to utilise it as his network's obligatory passage point. The case "[t]o Church's dismay" was stolen by Proxmire even though this committee and network "lacked the documentation that Church's staff had been gathering" (Ashby & Gramer 1994, p.462). Because the Lockheed bribery case was the most prominent and front and centre case during this period, Proxmire investigated this case to persuade and recruit other actors to enrol in his network. During August 1975 he held a one day hearing on 'Lockheed Bribery' as part of the Committee on Banking, Housing and Urban Affairs. The purpose of the hearing was to investigate "[t]he exact nature and purpose of ...[illegal] payments" as well as the guarantee loan that was given to Lockheed by the Congress (United States 1975b, p.1).

Members of the Lockheed board of directors were among the witnesses who testified on the day. Their rhetorical testimony concerned the benefits of Lockheed's operation for the U.S. economy and tax payers. It was claimed that Lockheed had "not used corporate

funds to make political contributions in the United States”, had not “violated any U.S. criminal laws in connection with its activities here or sales abroad” and as far as their financial statements were concerned “no material changes” were required (United States 1975b, p.27). Bribery was identified as necessary “to compete successfully in many parts of the world” (United States 1975b, p.27) and it was perceived as a “cost of winning the competition” (United States 1975b, p.45).

Lockheed was the sole corporation that had borrowed from the Government under the Loan Guarantee Act. The act enabled Lockheed to borrow money from a “consortium of banks ... [which] the United States was authorized to guarantee that the banks would not lose money on these loans” (United States 1975b, p.25). The guarantee loan was for “\$250 million of the taxpayers’ money” (United States 1975b, p.4; Yockey 2013). The loan was approved by the Congress on the basis that Lockheed was able “to achieve its projected sales figure” (United States 1975b, p.1). Based on the GAO representative testimony during this hearing, the act had directed the GAO to periodically undertake “a detailed audit” of “the books, records and transactions of any borrower under the Act” (United States 1976a, p.56). GAO responsibilities, based on their interpretation of the details of the act, were limited to auditing Lockheed to confirm its ability to repay the loan using its assets. The GAO representative explained that the “nature, intensity and extent” of the details of the law was interpreted by the GAO differently and contrary to the laws intent and principals, partly due to their lack of experience and authority (United States 1976a, p.56). This was also related to the GAO’s unfamiliarity with required specific investigative techniques (United States 1976a). Furthermore, the GAO

had no authority to take action in the event misconduct was discovered or suspected. Criminal or civil fraud cases had to be referred to the Department of Justice.

Senator Proxmire was concerned that the Government was not interested in investigating Lockheed's laundering money and establishment of "off the books" accounts, although bribery and other illegal activities were condemned by the Government. Secretary of the Treasury, Secretary Simon<sup>35</sup>, in his opening statement at the Lockheed bribery hearings stated:

[I]et there be no misunderstanding: The Emergency Loan Guarantee Board does not and will not condone illegal and unethical activities by American business, here or abroad ... [it] condemns such actions in the strongest terms and is deeply concerned about the possible improper use of Lockheed's corporate funds and its impact on the guarantee program (United States 1975b, p.5).

The reason being, the Government was mainly interested in Lockheed's financial position, their ability to secure sales, and increase their revenue to repay the Guaranteed Loan. Proxmire felt "we are put in the position of, if not condoning it, at least not taking any action to stop it" (United States 1976a, p.58). He later argued

Secretary William Simon condemns the Lockheed bribes and other payoffs in the strongest terms. But ... has failed to exercise his authority as Chairman of the Loan Guaranty Board to require Lockheed to disclose full details of the bribe (United States 1976a, p.151).

However, the State Department representative at the 'Abuses of corporate power' hearings described the matter as "being pressed with vigor" by the Department of Justice who had at times made inquiries into Lockheed's payments (United States 1976a, p.156).

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<sup>35</sup> He was also chairman of the Board in charge of investigating Lockheed's bribe payments. The SEC's then chairman, Ray Garrett was also a member of this Board (United States 1975b). Garrett was the SEC chairman from 1973 to 1975.

The Emergency Loan Guarantee Board (ELGB) had also required Lockheed's board of directors to establish "a definitive corporate policy" in relation to prohibiting illegal foreign commissions and payments, by controlling "the company's relationship with foreign consultants ... as a condition to the continuance of the guarantee program" (United States 1976i, p.89-90). The policy was to be closely monitored by the ELGB to ensure no illicit payments were made in the future (United States 1976i). Then again the concern was that the additional requirements of the ELGB would only be "paper promise and token procedures that purport to prevent future bribery" (United States 1977d, p.145). Secretary Simon assured Proxmire and his committee that the bribes and kickbacks would not continue in the future and if so, the loans would be stopped (United States 1975b). Nonetheless Proxmire was not satisfied as "Lockheed did not tell its board of directors or the Loan Guarantee Board or their accountants" about these payments (United States 1975b, p.19).

Until 1975, Lockheed had provided Congress with "incomplete and unverified" information from which "the names of the recipients, the specific contracts and the names of the countries" were missing (Dardess 1979; United States 1975b, p.3). The SEC was also denied access by Lockheed and the State Department<sup>36</sup> to Lockheed's accounts as well as releasing any information to the public or foreign governments. Even "after lengthy negotiations with the SEC ... Lockheed [would] agree to make partial disclosure of the information it had on its foreign payments" (Dardess 1979,

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<sup>36</sup> Secretary Kissinger intervened in the SEC/Lockheed court case and limited the SEC's access in relation to public disclosure of bribery information.

p.650). Lockheed in an arrogant reply to the request for detailed information said that since the SEC is

not able to assure confidentiality of the information being provided ... to avoid unnecessary risk and potential harm to Lockheed's shareholders and creditors ... we do not feel it prudent to provide all of the data which you have requested (cited in United States 1976k, p.10).

The main reason for this behaviour was that publicly available information was perceived by the Government and State Department to be jeopardising their foreign policy interests. The "premature disclosures of allegations" was furthermore claimed to "be used to create problems for both innocent and possibly guilty" parties (United States 1976i, p.116). Disclosure of the identity of the people involved in payments of bribes was viewed by Proxmire as an effective action to stop these payments (United States 1976k). However, he found the arguments by administration witnesses "rather persuasive because nobody wants to smear an innocent person" (United States 1976i, p.116). Further Proxmire, in his newsletter wrote the reason for Lockheed not disclosing the details of its bribery was its dependence "on the same sales agents who were involved in past bribery" (Proxmire 1976, p.2). Former Ambassador, Braden, and Under Secretary of State, Ball, were in agreement with Proxmire's comment. Braden and Ball both had formed an alliance with Proxmire and his actor-network. Ball interpreted the State Department's position as "a kind of conspirator in collaborating and maintaining the practice or at least in covering it up" (United States 1976i, p.43). This issue was viewed to be a future problem in relation to enforcement and criminal prosecution under new legislation that was to be enacted. Further illustrations and details will be provided in chapter five.

### 3.2 Interessement Moment of Proxmire's Network

The several hearings held by Proxmire can be demonstrated using ANT, as a way of assuring other actors in the network of his central role and goals. The main focus of the hearings was twofold. Firstly expanding and securing Proxmire's network through engaging the SEC and secondly, enacting legislation which required disclosure of illicit payments. The section below provides details of the twofold focus.

The first focus of the hearings was the SEC's voluntary program and engagement of the SEC as a representative of the accounting standard setting body in the actor-network. By establishing a role for the SEC, Proxmire was able to assure the existence of his network. Cases of bribery and illegal payments had demonstrated the need for enrolment of a body, such as the SEC as the corporate regulator, that could reveal the deficiencies of accounting regulation. The SEC could assist Proxmire in forming new legislation that contained sections relevant to corporations' disclosure of their financial information.

As briefly explained in chapter two, the SEC's program was initiated mainly because of the Watergate hearings and investigations into corporations' lack of disclosure of illegal political contributions and payments. Watergate gave the SEC grounds to request some of the corporations to prepare reports to disclose their illicit payments, through the voluntary disclosure program. As already discussed in chapter two, the Gulf Oil Special Review Committee, chaired by McCloy, was a response to the SEC's voluntary



disclosure program. The McCloy report provided details of illicit payments and recommendations for formation of future guidelines for companies. McCloy had suggested a thorough examination instead of an early “rush to statutory remedies before the whole case ... and all the factors [were] weighed” (United States 1976i, p.5). One of his suggestions to the subcommittee was establishment of a comprehensive definition of bribery. The reason being, bribery was defined generally and broadly and was not, according to lawyers, “within the mischief” of what the committee wanted to achieve (United States 1976i, p.9). The other issue addressed by McCloy, was for Proxmire to consider implementing the ‘materiality’ concept in his bill in relation to disclosure of illegal contributions. McCloy’s arguments and reported outcomes were on the same page as Proxmire, as explained in chapter two and will be explained in the following chapter, since McCloy had observed a need for future guidelines for companies. Hence, it could be argued that he was enrolled into the network as a new actor.

At the request of Proxmire, and the Senate subcommittee, the SEC prepared a report based on the voluntary program outcomes. The report found “[m]ore than 400 corporations...admitted making questionable or illegal payments” and “reported paying out well in excess of \$300 million in corporate funds” (United States House of Representatives 1977, p.1). These funds, according to the program report, were not recorded accurately in the records and books of the corporations and were concealed from external directors and auditors who were themselves linked to the circumvention of the system of corporate accountability (Securities and Exchange Commission 1976b; United States 1976n). Senator Proxmire applauded the SEC’s efforts on this subject by saying “if all agencies were as diligent as you are, and as competent as you are, and as

concerned with the public interest and with ethical conduct by American business, we wouldn't have the problems we have" (United States 1976a, p.38).

The other focus of Proxmire and the Senate subcommittee was establishment of new legislation requiring public disclosure of illicit payments. For this reason, Proxmire needed the support of the SEC as the corporate regulator. He wanted to "act forthwith" and without delay (United States 1976i, p.14), since he was concerned that "like so many other things that happene[d] in Washington and the country, ... [concern over illicit payments would be] likely to die down as time goes on and", the practice was likely to be accepted (United States 1976i, p.10). Ralph Nader shared the same view arguing for a push for reform combined with disclosure requirements,

[o]therwise, we will see an attitude spread in this country ... where no matter how abusive both governmental and corporate and other institutions may be, the people just shrug their shoulders and say, 'Well, what else is new?' (United States 1976i, p.16).

The proposed bill by Senator Proxmire was S.3133<sup>37</sup>. The intent of the bill was to require corporations registered with the SEC to file reports pertaining to their foreign payments and contributions. The bill made it a criminal offence for corporations to accept or offer/make foreign political contributions. One of the reasons he introduced this bill was "corporate abuses were accompanied by false or inadequate corporate books and records and that most of the cases involved illegal or improper domestic and foreign payments" which did not "constitute a violation of [the] SEC's laws or regulation ... constitut[ing] criminal violation" (United States 1976a, p.33). From

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<sup>37</sup> The details of the bill are provided in the following chapter.

Proxmire's point of view, criminal injunctive was by far more effective than civil, as civil actions "are slaps on the wrist" with no fine, punishment or dismissals. It could only lead to defendants arguing "they will be good boys" (United States 1976a, p.33) while not halting reoccurrence in the future. Chapter five will detail the proposed bills to the Senate.

### 3.3 The SEC's Voluntary Program

Even though Proxmire applauded the SEC's efforts in revealing the violations of the federal securities law, falsification of corporations' financial records and use of secret payments, the voluntary program had its shortcomings. The shortcomings were demonstrated by Senator Proxmire and Congressman Moss (explained later in this chapter) in the hearings they held and even future hearings held in 1977. By demonstrating the shortcomings, it can be explained by ANT that Proxmire was able to comprehend the reliability of the outcome of the voluntary program. In order for the program to be effective and to overcome its problems, Senator Proxmire's suggestion was the establishment of regulation prohibiting bribery and having the requirement of "systematic disclosure of all foreign consultants' fees" (United States 1976i, p.3). This was a way of promoting Proxmire's solution to the problem of illicit payments as well as reinforcement of his network's existence. Meeker, from the Center for Law and Social Policy and former ambassador to Romania, agreed with Proxmire on the need for the SEC "to adopt regulations requiring disclosure of all bribes, payoffs, questionable foreign payments, and ... the disclosure of all commissions to agents and consultants and fees" (United States 1976i, p.71).

Adams, director of Military Research, Council on Economic Priorities, had stated that the initial problem with the program was that it had gradually developed “out of individual investigations and injunctions directed at specific companies whose questionable payments at home and abroad had caused widespread public comment” only (United States 1977g, p.28). So when the magnitude of the problem became apparent, the SEC took the voluntary option of collecting relevant information. The amount of information that was provided by the companies was “less detailed than those which ... resulted from court orders” (United States 1976a, p.11). This was partly due to the SEC’s lack of power in “keeping the disclosures completely confidential” because of “the Freedom of Information Act and newspaper reporting” and to some extent making corporations “reluctant to comply with” the program (Adler 1982, p.1744).

The other fact was that the guidelines provided by the SEC were loose and flexible and lacked detailed mandatory rules and procedures (United States 1977g). McCloy, in the April hearings of the Banking, Housing and Urban Affairs Committee said “I have been told quite authoritatively that the SEC has been unable or unwilling, as yet, to come up with any guidelines as to corporate behavior in ... foreign payments” (United States 1976i, p.6). The SEC’s position in relation to the program and lack of having defined guidelines was viewed by one of the members of the AICPA advisory group as not being responsible (Hanson 1976), because it could have long term effects on the ability of the SEC to effectively deal with illicit payments (Hanson 1976). The lack of definitive guidelines, rules and procedures led to corporations defining questionable payments in their own terms leading to selectively reporting or ignoring the facts available. As discussed in chapter three, the SEC in its investigations had relied on these

reports prepared by managements with the assistance of their independent auditors. Harrington, Massachusetts Congress representative, was also concerned regarding corporations' reluctance in revealing "even most general information about their illegal activities" (United States 1977d, p.145). The adequacy of companies' disclosures to the SEC was doubtful and was questioned by Senator Proxmire and Congressman Solarz. Solarz, as an actor in Proxmire's network, said that the "proof is in the pudding" since it was uncertain that corporations would voluntarily disclose "substantial illegal payment in such a fashion that it was clear to anybody who read the statement that they had made an illegal payment" (United States 1975a, p.77).

Proxmire questioned the ability of the companies "to police themselves effectively under any circumstances" (United States 1976a, p.19). His argument was that, corporations had disclosed their illicit payments to "get easier treatment" which had undermined "the tough question [of] ... how pervasive and widespread" the problem was (United States 1976a, p.21). Congressman Solarz also observed that even if a corporate executive's cover up of bribe payments come to the SEC's attention

the worst that can happen is he will get an injunction requiring him to disclose it, which is what he would have done in the first place if he had wanted to ... there is literally no incentive ... to disclose these payments (United States 1975a, p.77).

The program had also relied on the boards of directors to conduct investigations and prepare reports for the SEC. Even the auditing procedures by auditing firms, were not extended "to uncover improper payments" (Hanson 1976, p.1). As argued by Adler (1982, p.1744) "the program overestimated the power of independent directors and

outside counsel to compel disclosure of payments”. These directors, as claimed by Ralph Nader and Proxmire, were friends such as McCloy, and relatives of the executive officers, who were handpicked to dominate the board, possibly leading to a lack of “external accountability that encourages responsible and lawful decisionmaking” (United States 1976a, p.97). Lockheed was one of the corporations that had used its own board of directors to perform the investigation and Proxmire was “not sold” on that (United States 1976k, p.68). Some of the corporations had employed independent compliance officers. However, Nader felt the independence of these officers could have been undermined by the corporations’ executives as they were under their “direct thumb” (United States 1976i, p.21).

Senator Proxmire was also concerned with the number of corporations that had come forward as part of the voluntary program. The public only knew of corporations who had come clean and not the ones who did “not volunteer their guilt” (United States 1976a, p.91). The Oversight and Investigations Subcommittee also raised concern about the SEC’s lack of effective enforcement, since the “essential complement to the corporate recordkeeping and auditing system is” its enforcement action (United States 1976m, p.484). The subcommittee argued the SEC’s “lack of will to run an adequate enforcement program” (United States 1976m, p.485) meant “that there may be many other companies which have not come forth” (United States 1976h, p.41).

As stated in the SEC report submitted to the Banking, Housing and Urban Affairs Committee, more than 9000 corporations under SEC authority, at the time only 100<sup>38</sup> had disclosed questionable and illegal payments. The SEC believed “the present evidence of corporate abuse, while indeed serious, does not support any general condemnation of American business” (United States 1976n, p.54). Parsky, Assistant Secretary for International Affairs, had also argued that “[o]nly a relatively few firms appear[ed] to have engaged in making questionable payments abroad” which meant that the “vast bulk of ... firms conduct their businesses ethically and completely in accord with the laws of the United States” (United States 1977d, p.84).

In the SEC’s view, the disclosure system, initially established by the Congress in 1933 and 1934, was sound and did not require “radical reform or renovation” (United States 1977e, p.2), and even though the problem was widespread, it was controllable and did not “represent an inherent defect in ... [the] economic system” (United States 1976n, p.56). The SEC was playing a dual role, one as a spokesperson of the Proxmire network and the other as an actor of the accounting profession’s network. The SEC believed in the accounting profession’s responsiveness and had observed that major changes were being undertaken in auditing practices. It had encouraged the Congress to give the AICPA “time to regulate the professional practices of its members” (Hohenstein 2009). The lack of alertness of the accounting profession in the past was claimed by the Commission’s chairman, Hills, “to be immaterial today” as the accounting profession were seem to be “moving forward” (United States 1976l, p.6). However, this point of

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<sup>38</sup> Before the program was over “more than 500 companies” had disclosed questionable payments to the SEC (Biegelman & Biegelman 2010, p.10)

view was not shared by Senator Proxmire. He referred to a court case in 1962 where the person had

got a cease and desist order ...and yet for 10 years they went right on doing exactly what they were doing before and nobody did anything about it. They really made no attempt to enforce the cease and desist order and that was a formal court order (United States 1976a, p.23).

Senator Proxmire was also concerned with the SEC's ability to take action against corporate management or executives who had made the decision to authorise the illicit payments thereby violating laws. His argument was, despite the SEC's "startling and dramatic disclosures" to the Senate subcommittee, "there ... [was] not a record of many resignations or firings" (United States 1976a, p.20). Harrington, Massachusetts Congress representative, perceived the U.S. reaction to be "charitably characterized as glacial at best" (United States 1977d, p.145). The crime by executives was seen as

crime at the highest levels of these corporate institutions, [which] has a rotting effect through the society. Society is very much like a fish in this respect, it rots from the head down (United States 1976a, p.95).

The political concern was the cost of regulation to businesses and its indirect effect on society and the market. Most cases were concluded with consent decrees and Corporations' promises to obey the laws and rules in the future. In relation to the Lockheed case, for instance they even "went so far as to reward the officers involved by voting its former president and vice president each \$65,000 a year in pensions" (United States 1977d, p.145). This was while the Japanese Prime Minister was "imprisoned and released only after posting \$680,000 bail" (United States 1977d, p.145). In the U.S. even if a company was fined, the amounts were "insignificant compared to the amounts



illegally garnered” (United States 1976a, p.95). The fines were referred to by Ralph Nader as corporations’ “debt to society” which were minor (United States 1976a, p.96). Most corporate executives who had admitted to their wrong doings to the Watergate Special Prosecutor were

still presiding over their companies ... only two went to jail. They served a few months and were freed. Most are still ensconced in their panelled corporate offices with platoons of lawyers and public relations men at their disposal (United States 1976a, p.96).

Proxmire further feared

even though the issue is settled in theory, ... many companies will continue paying bribes if they can get away with it, because the potential rewards are so great and the risks are minimal. Nobody has gone to jail. Only three corporations have fired their chief executive officers. At most, there has been some unfortunate publicity. Even Lockheed is reporting increased profits (United States 1976i, p.1).

Proxmire arguments took place while in Japan, Italy, and Netherlands and other countries exposures of illicit payments had “produced strong public and governmental reactions” (United States 1976i, p.69). For instance in the Netherlands the royal family “was rocked by allegations that Prince Bernhard had received over a million dollars in ‘unofficial payments’ from Lockheed” (Church 1985, p.100). Professor Ratner as an actor within Proxmire’s network, in a separate hearing, agreed to Proxmire’s argument, and explained that U.S. courts were reluctant to send managers to jail as U.S. “criminal sanctions and procedures were originally thought of as punishment for murderers and robbers; people don’t feel comfortable applying them to corporate executives” (United States 1976f, p.387). Ratner further maintained U.S. courts considered it was the corporations that had violated law rather than corporate executives. The problem was,

corporations “can’t be sent to jail. They can be fined, but in many cases the fines are insignificant given the size of the corporation” (United States 1976f, p.387).

The lack of concrete response was partly due to the uncertainty and indecisiveness of the SEC in continuation of the voluntary program. As some of the commissioners wanted “to put the cap on this volcanic situation” and there was “a split among the commissioners” (United States 1976i, p.20). As Ralph Nader stated this situation was “not all encouraging” in relation to the extensiveness of the corporations’ disclosures (United States 1976i, p.20). He argued that even the SEC’s chairman, Hills, was “leaning towards lessening the rigors of disclosure for ... overseas payments” (United States 1976i, p.20). The other issue was the SEC’s lack of power to penalise or “even slap wrists” and the power mainly resided with the Justice Department (United States 1976a, p.109).

However, the Justice Department’s efforts in this regard, as explained by Proxmire were “not a very reassuring record under either party ... of Justice prosecuting top officials of corporations or ... top officials in government. They seem to be allergic to that kind of action” (United States 1976a, p.28). Ralph Nader believed that “this reluctance ... [was] as significant as the corporate abuses themselves” (United States 1976a, p.109). So, Proxmire wanted the SEC, as the network’s spokesperson, to directly take over the power of criminal enforcement “because the Justice Department has been so timid about prosecuting prominent corporate criminals” (United States 1976i, p.2) and white-collar crimes compared to prosecuting hoodlums (United States 1976i, p.15). He reflected his

assertion about the SEC's extension of authority in his proposed bill which will be explained further in chapter five.

Based on the above arguments, Ralph Nader's recommendation was also the establishment of laws that would make the responsible individuals in corporations accountable for their actions. By quoting a law professor that

we have arranged things so that the people who call the shots do not have to bear the full risk, that is, it is difficult to pinpoint and punish individual violations within that collective body called the corporation (United States 1976a, p.96).

His endorsement had reinforced the centrality of the primary actor's own role, and validating the proposed solution/goal. As well as strengthening Proxmire's actor-network.

For an effective enforcement action in relation to corporate abuse of their power, Nader argued two points. One was in relation to jailing and disqualifying of "corporate officers or directors in any American corporation or partnership for 5 years" and the other was calibrated fines based on the size of the corporation and the "size of the violation" (United States 1976a, p.97). The second point was argued to be vital, as with

penalties which are the equivalent of wrist slaps, the result is predictable. If we make the cost of a conviction sufficiently high, it should discourage many violations which now are profitable to pursue (United States 1976a, p.97).

### 3.4 Congressman John Moss and SEC Shortcomings

Due to the investigations surrounding the improper corporate payments problem and the SEC voluntary disclosure program, during 1975, the Congress became interested in “accounting standard-setting, the accounting profession and oversight by the SEC” (SEC Historical, Congress Gets Involved) as well as auditors’ duties and their effectiveness. Congressman John Moss was amongst the first to hold investigations and hearings in relation to the break down in the system of corporate accountability and the SEC oversight and enforcement role. Congressman Moss was the author of the Freedom of Information Act, giving the public the right to government records. He led the hearing that produced the Securities Acts Amendments of 1975<sup>39</sup> which was the most comprehensive securities legislation passed by the Congress since the passage of the original securities laws in the 1930s by President Franklin Roosevelt’s call for legislation after the great stock market crash of 1929 (Markham 2006).

Moss became the chairman of the House of Representatives Oversight and Investigations Subcommittee known as the Moss Subcommittee. The Moss Subcommittee examined the materials filed by corporations as part of the SEC’s voluntary program as well as reviewing the program itself (United States 1976h; United States 1976o). The hearings held by the Moss committee were heightened by the Watergate scandal investigations that were taking place at the same time. Questions were raised with respect to the auditing system and its failure to discover or report the political campaign contributions or the questionable payments. In this context, Congressman Moss argued “[s]ome accountants and auditors, surprisingly, contend that

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<sup>39</sup> The Securities Acts Amendments of 1975, amended the Securities Act of 1933 and 1934. The amendments removed the barrier to competition by establishing a National Market System which encouraged fair and efficient handling of securities transactions (United States 1976h).

they are not responsible for detecting fraud. The public wonders what their real responsibility is and to whom they are responsible” (United States 1976m, p.484).

The Subcommittee on Oversight and Investigations, initiated its investigations of governmental regulatory agencies such as the SEC since it was felt “that the Congress really ... [had] never in the past exercised its proper oversight role” (United States 1977d, p.147). The criticisms were in relation to “the assumption that government ... [had] lost touch with the governed ... [and] that the regulatory agencies are responding ... to their own need to survive” (United States 1976h, p.2). The investigations led to a comprehensive report of the study of federal regulatory bodies in relation to their “independence, performance, and economic effects of [their] ... activities ... under the Subcommittee’s jurisdiction” (Chapin & Gramling 1996, p.7; United States 1976h, p.4).

Moss wanted to ensure the establishment of “tighter government regulation of financial reporting” (Clikeman 2008, p.73). He wanted to ensure financial statements were accurate and truthful, taking into account that the accounting profession were able to lobby the government. Because from the committee’s review, the SEC had not fulfilled its statutory responsibility in relation to enforcement and establishment of accounting and auditing standards (United States 1976h). For this reason it can be said that Moss was enrolled as the new actor in Proxmire’s network. Moss’ aim was similar to Proxmire’s intent of improving the accuracy of books and records of corporations in protecting shareholders and increasing their confidence in the system of corporate accountability. From the perspective of ANT, the Moss investigations secured the existence of Proxmire’s network, by forming recommendations about the SEC voluntary program and their accountability and responsibility towards the public.

### 3.4.1 The Federal Regulation and regulatory Reform

The Moss Subcommittee argued that they have

found most clearly ... that regulation cannot be summed up in catch words, simple phrases, or rhetoric. It is a many-faceted process [which] is a dynamic process, like our government itself and like our society (United States 1976h, p.1).

In relation to the SEC, as per the subcommittee report, it had partly failed in its responsibility of exercising “its standard-setting and enforcement authority earlier regarding accounting practices” (United States 1976h, p.17). It had, in addition, failed in not exercising “fully its statutory authority to remedy deficiencies in generally accepted auditing standards” (United States 1976h, p.38). Even after the SEC took action concerning questionable payments, through their voluntary program, the sufficiency of their action, and “thorough follow-up investigations” were questioned by the subcommittee (United States 1977d, p.151). In some instances the SEC had failed to require corporations to disclose the detail of their specific questionable payments, while in other cases “to permit only generic disclosure” (United States 1977d, p.151).

From the Moss Subcommittee’s perspective, the breakdown of the system of accountability was related to the key stages of

internal corporate conduct and financial controls; board of directors; independent accountants, auditors, and legal controls; public disclosure of corporate practices and finances; and enforcement by the Securities and Exchange Commission (United States 1976h, p.31; United States 1977d).

The SEC’s role in this break down was partly due to its doubtful reliance on the private standard setting bodies which were created by the American Institute of Certified Public

Accountants (AICPA) such as the Accounting Principles Board (APB) and its successor, the Financial Accounting Standards Board (FASB)<sup>40</sup>. This is while

[t]he FASB ... had accomplished virtually nothing towards resolving fundamental accounting problems plaguing the profession ... and the manifestations of private accountant's lack of independence with respect to their corporate clients (United States 1976h, p.32).

The breakdown was also related to the “SEC’s reliance on the private accounting profession alone to assure that corporate records are examined by independent auditors” which was “insufficient to protect public investors and accomplish the objectives of the Federal Securities laws” (United States 1976h, p.38). The above subcommittee’s findings led Congressman Moss to doubt “the Commission’s success in securing cessation and remedial action” in this regard in the future (United States 1976h, p.41).

#### **4. Internal Revenue Service (IRS)**

As explained in previous sections, the enforcement of pre-existing laws such as the Corrupt Practices Act were part of the problematisation process instigated by the principle actors of the networks. The Intelligence Division of the Internal Revenue Service (IRS) was one of the governmental agencies responsible for investigating corporations who had paid political contributions and had recorded them as expenses, prior to the 1970s. Back then due to the Department of Justice (DoJ) lack of enforcement and prosecution of many of the IRS cases in relation to corporations’ tax violations, “the Intelligence Division lost interest in pursuing” these investigations (United States 1975c, p.773). The DoJ, in some cases took “guilty pleas under the Corrupt Practices Act which gave them a slap on the wrist” and according to the IRS it

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<sup>40</sup> Details of these bodies are discussed in chapter three.

did not deter corporations from engaging in these contributions in the 1970s (United States 1975c, p.773). The argument was that if “the Government had followed through and continued these investigations”, Watergate would not have occurred (United States 1975c, p.773).

Apart from the DoJ’s attitude towards prosecution of corporations, if the IRS, according to Proxmire, had exercised its power and conducted its duties to its full, the problem of illicit payments would not have occurred (United States 1976a). IRS activities and operations were supervised and directed by the Secretary of the Treasury Department and the GAO was responsible for “regularly auditing ... [the IRS’s] routine operations and records” (United States 1975c, p.10). The IRS written mission was “to encourage and achieve the highest possible degree of voluntary compliance with tax laws and regulations” (United States 1975c, p.1). Prior to August 1975, it did not require “taxpayers to furnish information as to payments of bribes or kickbacks” nor did it investigate corporations’ slush funds or “illegal deductions of questionable payments to foreign officials abroad” (United States 1976j, p.188-189).

The IRS received huge amounts of information relating to illegal political contributions from the Ervin Committee and the Special Prosecutor’s investigations. During December 1974 and August 1975 the IRS issued two separate guidelines related to “political contributions made abroad” and later regarding slush funds and “payments made through foreign subsidiaries” (Biegelman & Biegelman 2010, p.10). Due to the volume of information, the IRS had used computers “to collate it and ultimately to



disseminate the information to the field”. Afterwards the computers were removed and disbanded by White House interference (United States 1975c, p.777). Without the computers, the IRS was unable to retrieve the information at a later time which was critical to their investigation of illegal payments.

The Director of Intelligence Department of the IRS was ordered “to keep out of that activity” without any reasoning from the Office of the Assistant Commissioner of Compliance (United States 1975c, p.778). The Department did not have adequate power to detect and investigate serious criminal tax violations “as far [as] the revenue system ... [was] concerned” (United States 1975c, p.787). The majority of the IRS time was spent on small violations while giant violators were “responsible for the real aggregate losses of revenue to ... Government” (United States 1975c, p.787). Giant violators were described as the bigger fish with “more resources ... at ... [their] disposal in order to frustrate any efforts that might be undertaken to assess proper penalties” (United States 1975c, p.787).

The SEC voluntary program and the reports that were produced due to the program also triggered the IRS to review and investigate corporate practices in relation to foreign payments and indirectly becoming part of Proxmire’s network by testifying at Proxmire’s hearings. The IRS was also working with the Justice Department in assisting them in their investigations. The IRS involvement in the investigations “satisfied some critics’ view that the SEC investigations failed to monitor privately held companies” (Broehl 1998, p.325). The focus of the IRS was on issues that had significant tax effects

such as uncovering tax evasion and avoidance schemes. It was also concerned with the “bribes [that] were being charged off as legitimate business expenditures” (Broehl 1998, p.325).

## **5. President Ford Task Force**

Gerald Ford became the U.S. president upon the resignation of Nixon in August 1974, and in the wake of the Watergate scandal. He was the only politician to take up the vice-presidency and later presidency without being voted into office. Subsequently, like Church, he was running for the 1976 presidential election. Partly to assist him in winning the Presidency, in March 1976 he officially established a “10 member Cabinet-level Task Force on Questionable Payments Abroad” to perform a “full-scale investigation” regarding questionable payments abroad (Greanias & Windsor 1982; United States 1976c, p.136). The task force chairman was the then Secretary of Commerce, Richardson, and was directed by the President. In terms of ANT, Ford was creating a network consisting of agencies of the federal Government, such as Secretary of the Treasury, Defence and State to name a few, to handle the problem of questionable payments abroad to “meet the public demand for action without causing undue disruption to carefully crafted and already fragile international relationships” (Greanias & Windsor 1982, p.60). From Proxmire’s perspective it had taken such a long time for the task force to be established by the administration, “in view of the seriousness of the problem” of illicit payments (United States 1976i, p.119). He was sceptical that the task force like the SEC and the Congress would be able to devote any considerable amount of time to investigate and study the problem. Proxmire noted that

[d]espite the excellence of the men appointed to the task force, it ... [was going to] be a stall. The Cabinet committee to study a problem is, by definition, a prescription to delay making hard decisions. Cabinet members, heads of Government departments are busy men and they have many duties and I'm frankly sceptical as to how much time they have to devote to the study of bribery (United States 1976i, p.119).

To secure his network, he argued that this task force was different from other investigations as it was “a coordinated program to review” the questionable payment cases and “to explore additional avenues ... in the interest of ethical conduct in the international marketplace and the continued vitality of ... [the] free enterprise system” (Ford 1976). Ford’s purported aim was to develop a comprehensive government policy to address these payments due to its impact on the economy. Whereas, as explained in the previous sections, the aim of Proxmire’s and Church’s network was imputation of “American morality into the conduct of American business abroad” (Greanias & Windsor 1982, p.60).

The purpose of the task force was partially similar to the SEC’s voluntary program and the subcommittees’ hearings held by Church and Proxmire, “to conduct a sweeping policy review ... and to formulate a coherent national policy” with clear and enforceable criteria on the illicit and foreign payments (United States 1976i, p.77) but “not to punish American corporations” (Greanias & Windsor 1982, p.50). The SEC, however, was not part of the task force but the chairman of the task force argued that if required, the SEC would “be invited to participate in the efforts of the task force” (United States 1976i, p.77). The task force was in charge of developing a policy “to understand the character and scope of the problem” and not investigating cases only as

opposed to the SEC's voluntary program (United States 1976i, p.40). The President on this matter had said

[a]lthough the Federal Government is currently taking a number of international and domestic steps in an attempt to deal with this problem, I believe that a coordinated program to review these efforts and to explore additional avenues should be undertaken in the interest of ethical conduct in the international marketplace and the continued vitality of our free enterprise system (United States 1976i, p.58).

The President wanted the U.S. to take the lead in advocating "free, honest, and competitive economic behaviour" in the international marketplace (President Ford 1976, p.1). In the view of the task force, the questionable payments were conceived to be "a diplomatic problem" (McManis 1976, p.220) and the current law was insufficient to address the problem and initially there was a need for an international treaty. This argument was supported by the President himself and was reflected in the bills proposed by the Task Force in 1976. As will be detailed in the following chapter, the proposed bills "treated all questionable expenditures as extortion payments and the entire problem as primarily one of foreign relations" (McManis 1976, p.221). The bills were not considered by the Congress during 1976, as it was in recess during June and August for the Republican and Democratic conventions and also it was an election year (United States 1976i, p.109). As such, the Congress was going through a difficult year. For this reason as well as the underlying purpose of the bills not being approved by the congressional hearings and their members, the bills were not approved by the Congress and it led to eventual breakdown of the Ford network.

## 6. Conclusion

The need for new legislation was apparent from the hearings and investigations that were led by the Senate, House of Representatives, the SEC and the President's task force. Networks were created as a result of these congressional hearings to put an end to the problem of questionable payments by corporations and politicians, domestically and internationally. The hearings assisted with shedding light on corporations' disclosure and record keeping of their political and international affairs. Similar to the Ervine Committee, corporations were found to be using their subsidiaries to conceal the political contributions. Advertising, marketing or research accounts were used for this purpose while the board of directors, shareholders and sometimes independent auditors were not advised of the payments and how it was recorded in the books of the company. The lack of transparency and accountability was prevalent in the cases presented.

Accordingly, Senator Church and Senator Proxmire, as the proponents in establishing their networks, as well as President Ford, independently presented different bills to the Senate and House of Representatives to regulate U.S. corporations in relation to these payments. The bills presented had different approaches to the problem of corrupt payments. The following chapter will explain the details of the bill's that were presented to the Congress and the success or the failure of the described networks in this chapter. Since the existence and indispensability of the networks are directly linked to the ability of principal actors to persuade actors within and outside network that their solution is the only possible way to halt illicit payments occurring in the future. The next chapter will explain the political and personal challenges the principle actors of

each network faced in getting the endorsement for their bill's presented to the members of the Congress.

# Chapter Five: The Tale of Shakedowns and Passage of the Foreign Corrupt Practices Act

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*The Foreign Corrupt Practices Act is a classic example of the ills that can be engendered by legislation shaped over a short period of time, under stress conditions, which draws support from different groups with different purposes, and which passes, ultimately, in the heat of a moment when something noble sounding must be done (Greanias & Windsor 1982, p.5).*

By examining the hearings explained in previous chapters, it can be said

[t]he reports of illegal domestic contributions that flowed from Watergate suggest that the problem may not be one of lower standards abroad, but low standards in general for U.S. corporate behaviour (United States 1977g, p.35).

This was highlighted as one of the key conclusions of the SEC report, as argued in chapters two and four, that

the almost universal characteristic of the cases reviewed to date by the Commission has been the apparent frustration of our system of corporate accountability which has been designed to assure that there is proper accounting of the use of corporate funds (Bathen 1978; United States 1976n).

The key element that makes the accountability system function is the disclosure and record keeping requirements to which corporations have to adhere. Some of the bills presented to the Congress during the 1970s included sections pertaining to disclosure requirements and corporate accountability. However, as will be noted in this chapter, some of the networks were not able to pass their bills through the Congress. The

absence of these requirements in the enacted bill and lack of enforcement of the passed provisions, as will be explained in the following chapters, led to similar problems resurfacing in 2000. The SOX act, as reasoned in chapter one, was enacted as the solution to the then identified and pre-existing problem of illicit and questionable payments. This chapter will refer to the SOX act where relevant.

The pattern of unethical and illegal payments explained in Chapter four and by Senator Church at the Subcommittee on Multinational Corporations' hearings was

that Gulf [Oil] invested heavily in Korea at the explicit urging of the U.S. government ... Northrop was carrying out U.S. government policy in promoting U.S. exports ... [in the Exxon case] the U.S. government played a critical role in influencing Italian legislation to favor the private foreign-American-oil companies. ... [T]he U.S. Department of State adopted a policy of hear no evil, see no evil (United States 1973a Part 12, p. 240).

The general consensus of the need for new legislation or guidelines was apparent from the hearings held by committees and subcommittees during 1975 and 1976. A review of previously held hearings demonstrate that this was the preferred solution by the principal actors to the problem of illicit payments, even though “there was a wide divergence of opinion ... on how the problem should be handled legislatively” (Dardess 1979, p.637). Nevertheless, the need “to restore public confidence in the integrity of the American business system” was apparent (Dardess 1979, p.637). This view, based on testimonies presented at the hearings, can be argued was not shared by the majority of corporations, actors outside the existing networks. For instance Bowen, chairman of Booz Allen and Hamilton consultants stated “A bunch of pip-squeak moralists running around trying to apply U.S. puritanical standards to other countries” and domestically (United States 1977g, p.33). He further even argued that he would not fire an employee making bribe payments abroad as this was part of his duties and job.



From the perspective of McCloy, as an actor in Proxmire's network, Government agencies could not "sit back and simply say, [l]et conscience be your guide but woe betide you if you make what we consider to be a misstep. ... [P]erhaps the Congress should bite the bullet and give some helpful guidelines" (United States 1976i, p.6). Public disclosure as a non-human actor and a preliminary deterrent system was seen as imperative. It was a common remedy proposed by actors testifying at the hearings and in proposed legislation by the created networks, explained in the previous chapter. Ralph Nader referred to this system as an "early alert-type system ... [that] makes the corporate executives think twice before" engaging in illicit activities (United States 1976i, p.18). A similar perspective was shared by Meeker, from the Center for Law and Social Policy and former ambassador to Romania, noting disclosure would stop corporate officers from engaging in corrupt practices due to the power of "public scrutiny" (United States 1976i, p.66).

Based on Callon's translation model, the Church and Proxmire networks were both at the mobilisation stage. The networks required spokesperson/people to communicate and represent the principal actor's solution to the Congress and the public, in order to gain further support for their solution. Both Senators Percy<sup>41</sup> and Garn<sup>42</sup> were playing the role of spokesperson for their network, the former representing the Church network and the latter, Proxmire's. Their role in terms of Callon's model could be "described as the progressive mobilization of actors who render the following propositions credible and indisputable by forming alliances and acting as a unit of force" (1986b, p.216). They

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<sup>41</sup>Senator Percy was a member of the Subcommittee on Multinational Corporations.

<sup>42</sup> Senator Garn was a member of the Committee on Banking, Housing and Urban Affairs.

both were in agreement with formation of new legislation that would curb corruption and bribery. At the same time, both were advising the networks not to rush into “this highly complex problem”, and to start to propose legislation and orbit it around to start the dialogue, comprehending the reactions and pros and cons (United States 1976i, p.38).

From the perspective of both principal actors’, disclosure requirements alone “may not be enough to protect all the interest that the United States has” and an appropriate level of penalty was necessary to be included in the proposed legislation by their networks (United States 1976i, p.70). Since the matter of concern was international, as transactions were performed in foreign countries, they were advised to frame an international code of conduct. This chapter will explain in detail the proposed legislation of the created networks of Church, Proxmire and Ford, and where possible reformation and breakdown of the networks or dissidence of the actors. The following section will explain the international resolution that was cosponsored by Senator Church and the issues surrounding acceptance of the proposed resolution by the actors enrolled/unenrolled in the networks.

## **1. International Resolution**

Public disclosure can act as a major governing tool for companies (Senator Percy United States 1973a Part 14, p.322), as well as for stakeholders managing their economic decisions and protecting their interests. Percy quoted from Justice Brandeis (1914, cited in United States 1973a, Book 12, p.15) that

[p]ublicity is just commended as a remedy for industrial disease. Sunlight is said to be the best disinfectant. A corporation avoids conduct that will prove embarrassing if disclosed; the possibility of future disclosure constitutes a major element in shaping current decisions.

Senator Church's outcome from the hearings he convened was that there was a need for a national and international solution with the focus on enforceable disclosure requirements, as the problem was argued to be worldwide. Companies were competing globally and corporate disclosure and anti-trust procedures were to be internationally harmonised and to be discussed in international forums, such as the International Monetary Fund (IMF), United Nations, and the OECD, so that the companies would not be disadvantaged in their dealings.

This position was also shared by the Department of State which argued "it would not be advisable for the United States to try to legislate the limits of permissible conduct by our firms abroad" (United States 1975a, p.24). It was mainly concerned about the U.S. efforts to legislate and impose a peculiar standard regarding corporate political contributions without an international code of conduct which would have been presumptuous and counterproductive (United States 1975a). As "the United States cannot police the internal affairs of foreign states" and "the only solution to corruption lies in the societies concerned" (United States 1975a, p.24).

Without international disclosure law, foreign companies and Governments would be willing to accept secret and unethical payments which would disadvantage American corporations. Senator Ribicoff argued this point saying

[i]t hurts us competitively to see that the American companies are the only ones being traduced, the only ones being blamed, the only ones being pilloried when we know that companies all over the world are engaged in the exact same practice (United States 1975d, p.35).

In this context, Senator Percy compared corruption to pollution since corrupt and bribe payments have “[polluted] ... democratic processes and free enterprise processes” (United States 1973a, Book 12, p.357). He stated you are not able to pass laws in relation to pollution in just one state of the U.S. or even national laws, as other states or nations still are able to pollute the lakes and the oceans (United States 1973a, Book 12).

Simultaneously, in October 1975 a “multilateral trade” (United States 1975d, p.31) resolution, Senate Resolution 265, was submitted to the Senate Committee on Finance with the purpose of protecting “the ability of the United States’ [to] trade abroad” (United States 1975d, p.24). Also, to “serve to dot the “i”s on laws that” were in place such as the 1974 Trade Act (United States 1975d, p.28). The aim was establishing “stronger laws that ... [would] force complete and accurate disclosure” internationally (United States 1975d, p.2). The resolution sought an international solution to not only prevent American corporations from participating in payments of bribes, kickbacks and political contributions in their international commercial dealings but also international corporations (United States 1975d). This would, create a fair ground for corporations to compete effectively in foreign markets. The Senate adopted the resolution “by a vote of 93-0” in 1975 (United States 1976i, p.79).

Senator Percy, as a member of the Subcommittee on Multinational Corporations, along with other senators had also urged the Government on the matter of enacting legislation

(United States 1976i). The United States Secretary and Treasury Secretary had started discussions with different countries and international forums, mainly the OECD, in relation to “business-government dealings”<sup>43</sup> and establishment of international “ethical guidelines” (United States 1975d, p.16). The discussions had started at a time when the OECD had initiated “the 1975-76 revelations of corrupt international sales practices” movement (United States 1976i, p.71). The OECD guidelines were to be “applicable to business firms [which] is an agreement among governments to prohibit international bribery” (United States 1976i, p.79). The U.S. had recommended the OECD include a provision in their guidelines specifically requiring corporations to perform their duties “within the framework of the laws and regulations of their host country” in relation to avoidance of any bribe or payoff payments (United States 1976i).

The discussions were partly influenced by U.S. corporations losing business internationally after the publicity of corporations’ bribery and illegal payments abroad and SEC’s investigations. Lockheed, for example, had “lost a substantial contract” to a French company as Lockheed did not pay bribes (United States 1975d, p.34). In this regard, the 1974 Trade Act provided the opportunity for the U.S. president to negotiate the extension of conditions of international trade by “bring[ing] international trade agreements into conformity with principles promoting the development of an open, nondiscriminatory, and fair world economic system” (United States 1975d, p.34).

However, the government’s international move was questioned in different hearings. McCloy on one hand was skeptical in respect of establishment of an international code

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<sup>43</sup> OECD had initiated a working party regarding restricting corporations practices (United States 1975d).

of conduct. His argument was, in order to enact an effective code, there is a need for creating a group which could study the situation and provide for a “far greater awareness” internationally (United States 1976i, p.8). Braden<sup>44</sup>, Assistant Secretary of State, also indicated his disagreement with the way the State Department was initiating the fight against corruption internationally. He argued that their proposal which contained “international treaties, bilateral or multilateral” was “futile and puerile” (United States 1976i, p.25). Likewise, Senator Ribicoff questioned the Government approach by arguing that the “OECD is a debating society. When has OECD ever accomplished anything?” (United States 1975d, p.21). The issue with the OECD was its lack of enforcement power since it was a study group issuing voluntary codes of conduct for only multinational corporations. A similar argument was made in relation to the United Nations. Proxmire, for example, said “[t]he U.N. has never impressed me as a very effective enforcement organization ... in countries that do not seem to have the will now to act against crimes of this kind” (United States 1976a, p.157).

The other concern was with the way the U.S. administration was negotiating and debating with the international forums. Their interest was only in talking with these forums and lacked actions and power to implement any rules or regulation. Senator Ribicoff stated, “[n]ow, if you are going to use your power, for heaven’s sake use it. It is not just a question of using your arguments and using geopolitics, but using ecopolitics” (United States 1975d, p.22). The argument was also about not only making proposals and negotiations with the OECD but also with GATT (General Agreement on Tariffs and Trade)<sup>45</sup>. The GATT was a body in which the U.S. had power and as well

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<sup>44</sup> Former U.S. ambassador to Argentina, Cuba, Colombia, and Chaco Peace Treaty.

<sup>45</sup> GATT was replaced by the World Trade Organisation in 1995.

had greater enforcement powers than other forums. The U.S. powers were explained by Senator Ribicoff as

every country in the world marks time until the United States takes a position, and they know where they stand, and here is an opportunity ... to place American business on the same basis (United States 1975d, p.35).

Another concern was regarding the content of the discussions that were taking place in international forums. The argument in the Senate hearing was to separate and avert morality and ethics from debates and move to arguments with reference to “discriminatory practices towards American industry” that needs to be abolished (United States 1975d, p.28). Senator Gravel said to not lecture

the world community. As ... they will be only empty words until the world matures to a higher level. We want to be the driving force to that maturity, and the best way to do that is to make these nations pay in terms of dollars and cents<sup>46</sup> (United States 1975d, p.28).

Proxmire was concerned with the length of time it would take to establish and enforce an international treaty. The State Department in their testimony to the Banking, Housing and Urban Affairs Committee announced that it would take considerable time, up to ten years (United States 1976i). The concerns became realised when by 1977 and 1978 the OECD issued a voluntary corporate code of conduct consisting of “nonenforceable documents that most observers agree[ed] did little to effect change in corporate behavior or public opinion” (Broad 2002, p.71). Also, according to Transparency International, the Anti-Bribery Convention of the OECD which became enforceable on members in

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<sup>46</sup> Senator Gravel was referring to a penalisation method.

1999 was not “consistently enforced”(Heimann et al. 2011, p.5) as a “result of lack of political commitment by government leaders” (Heimann et al. 2011, p.2; Yockey 2013).

## **2. Bills Presented to the Senate and House of Representatives**

The following sections of the chapter will explain in detail the different bills which were presented to the Senate and the House of Representatives by different Senators, Congressmen and the SEC in relation to questionable payments, from 1975 to 1977. Ultimately the Senate and the House separately decided on a bill to be passed as the FCPA. However, as will be discussed in this chapter and the following,

[t]he House version of the bill did not contain the accounting provisions at all, and ... were never debated on the House floor or in a House committee. In the Senate, the accounting provisions were overshadowed by the looming issue of overseas payments (The Committee on Corporate Law and Accounting 1978, p.309).

Accordingly this study’s main focus is on the bills presented to the Senate, with slight discussion regarding the House of Representatives bills. Since, the majority of the House bills were identical to Senate bills specifically those of Proxmire or Church. The ANT is primarily utilised for explaining the proposed Senate bills and the arguments for and against these bills that were created during the 1970s. The following sections will initially analyse the relevant bills presented to the House of Representatives and then bills formed by Senator Church, Senator Proxmire and President Ford.

### **2.1 Congressman Stephen Solarz’s Bills**

Stephen Solarz, a Democratic Congressman was elected to the House of Representatives in 1974, obtaining a seat on the Foreign Affairs Committee (Martin 2010). As part of



the House of Representatives Subcommittee on International Economic Policy hearings in 1975, Solarz introduced H.R. 7563. The significance of this bill was that it was the first bill presented to the House of Representatives concerning monitoring the overseas business activities of corporations by the Secretary of State to detect “any activities which may violate any Federal Law” (United States 1975a, p.4). It was initiated to deal with the problem of the failure of “the private sector and the executive branch ... to take the initiative to monitor overseas business activities and to bring a halt to these unacceptable business activities” (United States 1975a, p.4). Solarz argued that the time for taking effective measures was “long overdue” (United States 1975a, p.4) and that

the plea of Gulf Chairman Bob Dorsey that they need laws to protect them from being importuned by foreign politicians for donations and other financial considerations falls far off the mark and rings very hollow. One would hope that American business firms would have the foresight and mettle to police their own activities without the need for government control (United States 1975a, p.3).

He also had referred H.R. 7539 to the Judiciary Committee which had similar goals to the first bill as well as specifically prohibiting “the bribery of any foreign government, foreign official, or foreign political organization by any American company” (United States 1975a, p.4). The bill addressed, inter alia, criminalisation of payments of bribes and gifts to foreign officials or organisations, by including a section imposing “a fine of \$10,000 or 1-year imprisonment or both” for breaches of the act (United States 1975a, p.4). The bills did not include any sections pertaining to accounting matters such as full disclosure of events in financial records. However, no major actions were taken on these two bills and they were not referred to any other committee or the Senate. As the bills had died, Proxmire, Church and President Ford individually and in agreement with the actors of their network, presented bills to the Senate and the House of Representatives

during 1976. The details of the bills are as set out in the following sections, and are presented in chronological order.

## 2.2 Proxmire and His Proposed Solution

Senator Proxmire introduced S. 3133 to the Senate Committee on Banking, Housing and Urban Affairs in March 1976<sup>47</sup>, as the only solution to his proposed problem as part of his network's problematisation stage. His rationale for the timing of presenting this remedy at the hearing was that investigations that had taken place had established sufficient evidence to initiate a move on this issue. He wanted to confirm the existence of his network and avoid his network being contested by outside actors.

The Lockheed documents, the SEC report to the Senate Banking, Housing and Urban Affairs Committee and the McCloy report were seen to be helpful. While “some, who rhetorically condemn bribery as roundly as the rest, want[ed] Congress to delay a remedy until the entire fortune 500 ... [had] been investigated” (United States 1976i, p.76). Proxmire felt this delay was reasoned by Congress in a similar fashion to “an agency in the bureaucracy that was short on bureaucrats ... hired a talking parrot ... [and] taught him to say only one phrase: ‘Very complex, very complex’” (United States 1976i, p.76).

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<sup>47</sup> Two identical bills to S. 3313 were reported to the House of Representatives during May 1976. The bills were H.R. 13870 introduced by Moss and Stark and the other one was H.R. 13953 introduced by Pickle. Both bills were also identical (United States 1977d).

The bill amended the Securities Exchange Act of 1934, requiring “issuers of securities registered pursuant to section 12 of such act to maintain and to furnish reports relating to certain foreign payments” (United States 1976i, p.2). One of the sections of the bill specifically required public disclosure and “periodic reports relating to any payment of money or furnishing of anything of value in an amount in excess of \$1,000” as well as the details of the purpose of the payments and person or entity to whom the payments were made (United States 1976i, p.2). Proxmire had set a precise amount to avoid vagueness for corporations and Government. Also, to make it certain to corporations on what they should or should not report (United States 1976l).

Hills<sup>48</sup> feared that having a set threshold would “be a license for someone who will say ‘All right, up to that I can get away with it’” (United States 1977d, p.30). On the other hand, the SEC was reluctant to impose a “hard-and-fast rule”, as it might have affected the Commission’s “necessary flexibility to vary its disclosure requirements to fit the precise circumstances involved” (United States 1976n, p.60). Also, setting a certain amount would imply that corporation’s payments below that amount would be immaterial while in some cases it would be the opposite (United States 1976l). Hills arguments and concerns were similar to McCloy’s suggestion to Proxmire, as briefly detailed in chapter three, in implementing a concept similar to materiality doctrine rather than having a specific threshold. The bill as explained required disclosure of the identities of recipients of the payments, to effectively deter them from illegal activity. This was opposed by the SEC, as it was argued that their “primary function is not to try to cause changes in behavior”, but to “require a fair presentation of material facts” (United States 1976l, p.25).

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<sup>48</sup> Roderick Hills served as the SEC’s chairman from 1975 to 1977.

The SEC had only supported the bill's underlying philosophy of "need for remedial legislation" (United States 1976l, p.1). The SEC was mainly interested in extending the current available laws to include guidelines on disclosure of questionable foreign payments and not penalising corporate officials. Proxmire wanted to retain the SEC, as the spokesperson, in his network and avoid this actor becoming dissident. So, Proxmire agreed to the SEC drafting a modified version of S. 3133 and elimination of the disclosure requirement of his bill, since the SEC was not in support of the current version of the bill (Jacoby et al. 1977; United States 1976l). Accordingly, the SEC's modified version of S. 3133 that included their proposed accounting and financial reporting recommendations was presented to the Banking, Housing and Urban Affairs Committee. The modified version included "a prohibition against the making of false and misleading statements by corporate officials or agents to those conducting audits" and management establishment and maintenance of an internal accounting control system (United States 1976n, p.58). Further details of the modified version will be explained in the 'SEC's Bill' section of this chapter.

The Department of Commerce and other public witnesses, as part of the Proxmire network, who testified at the foreign and corporate bribes hearings, such as Ball, Nader, Senator Percy, and Braden to name a few, supported the public disclosure requirements of the bill. Meeker, from the Center for Law and Social Policy, supported the legislation rather than any guidelines established by the SEC or any other body as the guidelines would not have any validity (United States 1976i). As was explained by Ball, it was essential to firstly "put our house in order ... to make this illegal" and then move

towards an international agreement (United States 1976i, p.102). Proxmire too agreed on this point and was “convinced it will be effective” to pass legislation influencing corporations domestically. In addition, an international move towards a treaty was going to take extensive time, the outcome was uncertain and enforcement would be feeble as argued in the previous section (United States 1976i).

Even though actors of the Proxmire network were in general in agreement with the bill, they had different opinions in relation to his proposed solution. Different arguments and ideas by these actors could have either strengthened the bond between actors or vice versa. Proxmire, as the principal actor and chairman of the hearings, was the authoritative actor in charge of keeping the network intact. For example, Ralph Nader’s suggestion was the addition of a provision to the bill whereby the SEC would require the appointment of a “compliance officer ... by the board of directors”, to monitor the disclosure requirements of corporations (United States 1976i, p.19). He also argued for tighter language as corporations could “escape the embrace of this bill through elaborate intermediaries” (United States 1976i, p.21). While the State Department, during their appearance at the ‘Foreign and Corporate Bribes’ hearings, was more in favour of an international remedy than unilateral action by Congress or Government agencies. Since already the SEC required “substantial disclosures” from corporations (United States 1976i, p.101). Accordingly, a disclosure requirement at that time would have been premature.

The bill had its shortcomings as argued by its opponents, which led to actors analysing and criticising it. The inherent limitation of the bill was that it only encompassed

corporations coming within the SEC rulings and did not cover privately held corporations (United States 1976i). The argument was that illicit payments offered by private companies or partnerships are not dissimilar to payments paid by publicly held corporations. Another weakness was that the bill mainly focused on foreign payments and not small gifts that were paid domestically by corporations. Both Proxmire and Nader agreed that “mere gifts” were extremely corrupting as it was “more difficult to trace” and would “tailor itself beautifully to the particular individual in the company” (United States 1976i, p.20).

A third issue was with the bill extending the SEC’s authority to “initiate ... , prosecute, and appeal any criminal action arising” from foreign payments (United States 1976i, p.3). Public witnesses at the hearing where Proxmire presented his bill opposed this section. The SEC was an administrative government agency with abilities to adjudicate, make rules, and investigate, consequently, criminal prosecution authority was dangerous (United States 1976i). The Justice Department, as explained in chapter four, held this authority. Even though the Justice Department was not responding to criminal prosecution requests due to

political indifference, lack of adequate resources dedicated to these corporate violations, and the U.S. District Attorneys around the country ... [had] not been instructed by the Justice Department to pay sufficient attention to these problems either (United States 1976i, p.22).

Proxmire recommended, in agreement with Nader, extension of an existing SEC power. Which was a more effective remedy “to empower the SEC to remove officers or executives who ... engaged in corrupt practices” (United States 1976i, p.23). This was perceived by Proxmire and a few actors of the network to be similar to the SEC’s power “to suspend broker-dealers for bribery” (United States 1976i, p.23). However, this

endorsement was not agreed upon by all the actors of the network, as argued by Proxmire in his 'Foreign and Corporate Bribes' hearings. McCloy had contested this issue in his appearance in the Senate hearings as well (United States 1976i). The SEC's extension of power was discarded in the modified versions of S. 3133.

### 2.3 Senator Church's Network Outcome

In May 1976, Senator Church along with Senators Clark and Pearson, as actors of the Church network, referred a bill, S. 3379, to the Senate Committee on Banking, Housing and Urban Affairs and the Senate Committee on Foreign Relations. The title of the bill was the International Contributions, Payments, and Gifts Disclosure Act. The major thrust of the legislation and the network's solution was public disclosure of payments made to foreign government officials, entities or agents (United States 1976i). Since his committee and network were mainly investigating and scrutinising multinational corporations' accounts and financial records. The vitality of his network was striving to achieve formation of a bill with the focus on corporations' adequate disclosure of information in relation to illicit contributions. An identical bill to S. 3379 was presented to the House of Representatives by Solarz. The bill was H.R. 14340 which was introduced in June and focused mainly on the disclosure of contributions made by companies abroad. The following section will demonstrate the details of S. 3379 and Church's network, which demonstrates the details of the House bill as well.

The provisions of the bill were similar to S.3133 and called for amendment to the Securities Exchange Act of 1934. It "was an extremely comprehensive measure"

(Bathen 1978, p.1254) with a twofold focus. On the one hand, the bill's emphasis was on the shareholders, potential investors, and boards of directors and auditors of the company, by requiring corporations to disclose detailed information pertaining to foreign and political contributions, payment and gifts in their financial reports. On the other hand, it included provisions relating to corporate governance. The proposal included "criminal penalties for failure to comply with its disclosure provisions" (Bathen 1978, p.1254). The Bill provided private rights for action by shareholders and competitors who could prove actual damages as a result of improper payments (United States 1976l). If the damages were proved to be correct, "treble the actual damage" and "costs of the action and reasonable attorney's fees as determined by court" could be recovered by shareholders and competitors (United States 1976l, p.36). This was because some U.S. corporations were found to be paying bribes in order to compete with other U.S. corporations entirely and placing them at a competitive disadvantage. This section provided corporations with a right of action against their competitors (United States 1976l). The importance of the bill, based on the findings of the subcommittee, was that bribe payments and kickbacks could lead "corporate interests to take precedence over United States foreign policy objects" that could "create and foster an anti-American sentiment in individual foreign countries" (United States 1976l, p.32).

S. 3379 required sworn disclosure statements of fees, commissions and gifts paid "to [an] agent or employee of a company or its parent ... in connection with ... direct and indirect political contributions to foreign governments [and] ... nongovernmental purchasers and sellers" (United States 1976l, p.33). Disclosure statements were to be detailed and issued annually. The bill's provisions were required to include details of



the amount, the names of the parties involved, the purpose of the contribution or the payment as well as the “identification of relevant foreign law” and to be recorded and kept for 5 years. The aggregate values of such payments were also required to be included in a company’s financial statements. The SEC was required to present this information to the State Department for their analysis in terms of their foreign policy (United States 1976i).

The bill also contained a section in relation to the board of directors and audit committee composition and their duties. The main focus of this section was independence of the members of the board of directors that could constitute the audit committee of the company as well which was similar to section 301 of the Sarbanes Oxley Act (SOX) that was enacted later on in 2002 (as briefly pointed out in the introduction chapter of this thesis).

A similar statement was made by Phillips, the representative from the Centre for Law in the Public Interest and a new actor in the Church network during the Commerce Committee hearings held in June 1976. The Centre was working on “a new litigation project on corporate responsibility” which involved lawsuits against corporations involved in illegal payments such as Northrop Corporation and Lockheed (United States 1976f, p.438). From their close analysis, they found weaknesses in the structure and responsibilities of the boards of directors of the corporations. The purpose of the board was, in their experience, “more illusory than real. Directors ... [had] become management appointees and shareholders ... [were] an amorphous mass lacking effective representation or the machinery to organize” (United States 1976f, p.443). As

happened subsequently in WorldCom and other cases, for example, in the Northrop case “the Board was essentially rubber stamp[ing]” decisions of the CEO since he had “hand-picked Board members who were either his social or business contacts” (United States 1976f, p.440). This example also brings out Church’s argument in relation to independence of the members of the board, which from Phillips’ point of view was one of the basic problems in their cases.

The other focus of Senator Church’s bill was the duties of the audit committee and their involvement in the internal systems of the company and internal investigations which was again parallel to subsections of the SOX section 301. The bill stated it was “the responsibility of any independent auditor hired [by the audit committee] to inquire fully into any illegal, unusual, or questionable activities” (United States 1976l, p.35). This particular focus of the bill was partly linked to investigations of corporate accounts about illicit payments as explained in chapter two and partly chapter four. Phillips also testified that audit committees can help in ensuring “all the information will be presented to the board in some responsible form” (United States 1976f, p.445). Phillips emphasised that from their experiences having a mandated statement by the SEC or the Congress would require the board to adopt these requirements. However, only if corporations are non-responsive to these requirements, then the “regulation option ... must be vigorously pursued” (United States 1976f, p.443).

Proxmire and Hills, in their speeches during 1976 both agreed that it was essential to have audit committees in place that would understand the scope of audit and management. Hills also claimed that to have an effective internal control system and

accurate records it is necessary to ensure boards of corporations include independent members (United States 1977d). However, having this section as part of the legislation was perceived to be unnecessary and was something the SEC could mandate through public accountants and auditors. This difference in opinion was the major factor in differentiating between the accounting provisions of the bills presented by Church and Proxmire. Also as far as the theory is concerned it demonstrates the role of the SEC as the spokesperson of Proxmire's network as well as the success of the principal actor in pursuing his solution. Chapters six and seven will detail whether the SEC was able to mandate these requirements and if the requirements were passed as legislation imposing requirements on corporations, since the Church bill was claimed to be "complicated and far-reaching" (Greanias & Windsor 1982, p.64).

Church's bill was presented at the Banking, Housing and Urban Affairs Committee in 1976, where the SEC chairman and commissioners were testifying. The SEC's then chairman, Hills, considered the bill would impose "far more of the role of being a governing body, setting accounting standards, setting accounting principles" on the SEC and would "dramatically change the role the commission ... serves in relation to private industry" (United States 1976l, p.22). He further argued, this "kind of dramatic change is not needed to meet the problems we have uncovered" (United States 1976l, p.22). The above arguments clearly explain the ability of Proxmire's network in mobilising its actors and spokespeople.

The Senate "elected to drop the disclosure requirement and go the criminalization route" (United States 1977d, p.178). S. 3379, as the preferred solution by Church's network

was rejected<sup>49</sup>. The bill was the main focal point of the network and it was the only reason that had kept the network transforming. The rejection of the bill on the basis that it was not “carefully tailored to what the genuine problems were and to go too far” meant that the network was falling apart and was contested at its mobilisation moment (United States 1977d, p.178).

William Kennedy, Co-chairman of the Special Committee on Foreign Payments<sup>50</sup> was in agreement with rejection of the bill, stating the SEC would have been “flooded with ... useless reports, and, because they would be published, you would have had some unhappy commercial consequences for the businesses involved” (United States 1977d, p.183). Portions of the bill “offered as floor amendments during Senate consideration of S.3664 [as will be explained in the following sections], ... were not adopted” and the bill was rejected (United States 1977g, p.91). The other reason the Church network was defeated and never reformed was that during this period, as previously detailed in chapter four, Church was also running for the 1976 presidential election as the Democratic nominee. He was also chairing another committee investigating secret agents, the CIA and the FBI, in the hope of reaching reforms in the existing government (Olmsted 1996)<sup>51</sup>. Furthermore, he was criticised by one of the Foreign Relations Committee staff, Holt, regarding his efforts in boosting “his presidential stock” by “just chasing more scandals rather than digging deeper into the causes of problems” (Ashby & Gramer 1994, p.465).

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<sup>49</sup> The identical House of Representatives bill, H.R. 14340, was also rejected.

<sup>50</sup> The special committee on foreign payments of the association of the bar of the city of New York. Kennedy was also the counsel for General Electric company (United States 1977g).

<sup>51</sup> The detail of these investigations by Senator Church are beyond the scope of this study for future readings refer to the following readings as a starting point, “Fighting the Odds: The Life of Senator Frank Church” and “Challenging the Secret Government: The Post-Watergate Investigations of the CIA and FBI”.

## 2.4 SEC's Proposed Bill

As argued before, the SEC redrafted S.3133 to embody their proposed legislative recommendations which was “a response that fit[ted] the problem” that was advised by Proxmire during his network’s problematisation moment (United States 1977d, p.28). The revised legislation, S.3418, at the request of the SEC, was presented to the Banking, Housing and Urban Affairs Committee in May 1976 as part of their hearings on ‘prohibiting Bribes to Foreign Officials’. The commission chairman argued the proposal was “a measured one, one that meets the problem we perceive”, and representing “a responsible reaction to the real problem of questionable and illegal foreign payments and practices” (United States 1976l, p.9).

The bill amended section 13 (b) of the Securities Exchange Act by adding three new clauses with “fairly standard language” (United States 1976f, p.310) to encourage accountability in corporations. S.3418 requirements consisted of corporations’ establishment and maintenance of adequate accounting books and records, as well as a system of internal control. Under the Federal securities laws, “no [such] explicit requirement” existed (United States 1976l, p.19). The SEC was putting “more emphasis on the accuracies of the reports ... [than] on the fairness of the overall bottom line of the company’s financial reports” (United States 1976f, p.310). These requirements from the SEC’s view point were to place a “new sense of responsibility ... upon the system to make it accountable” (United States 1976l, p.6). Moreover, to

provide the teeth to assure that problems of this nature ... [were] brought to appropriate levels of corporate management, and recorded in a manner that ...

[made] it far easier for ... [the SEC] to discover them (United States 1976l, p.19).

However, the bill did not contain any provision prohibiting illegal payments like the bills presented by Proxmire and Church.

The SEC's proposed legislation was based on a "straight-forward effort to deal with the problem that was uncovered" (United States 1977d, p.25) and required public corporations registered with the SEC to

- (A) make and keep books, records and accounts, which accurately and fairly reflect the transactions and dispositions of the assets of the issuer; and
- (B) devise and maintain an adequate system of internal accounting controls sufficient to provide reasonable assurances that
  - (i) transactions are executed in accordance with management's general or specific authorization;
  - (ii) transactions are recorded as necessary (1) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (2) to maintain accountability for assets;
  - (iii) access to assets is permitted only in accordance with management's authorization; and
  - (iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences (United States 1976n, p.63-64).

The phrase 'accurately and fairly' was used in section A to put "the responsibility where it belong[ed]" which was corporations who were fooling their auditors and not "any accounting firm" (United States 1977d, p.26). Holton, the chairman of the committee on SEC regulations of the American Institute of Certified Public Accountants (AICPA), had an opposing view asserting that this phrase was connoting "a concept of exactitude that is simply not obtainable, and there is no standard against which achievement of that precision can be measured" (United States 1977d, p.161).

Section B's objectives of a system of internal control was defined based on the accounting profession's definition. The generalised objectives were adopted from the Statement of Auditing Standard (SAS) 1, section 320.28 (Gary 1990; The Committee on Corporate Law and Accounting 1978) a rule that was developed for guiding auditors regarding accounting controls. It was stated that the profession's definition was "the authoritative accounting literature" from the AICPA (United States 1976n, p.65). While the AICPA was unclear in what way the SAS 1 "objectives harmonize with the proposed statutory command required to be implemented by the registrant" since it was oversimplified "to excerpt a particular audit concept" (United States 1977d, p.167).

The SEC believed by strengthening internal control, it could promote the corporation's responsibility to their shareholders in disclosing material facts (United States 1976l).

Since the purpose of this section was

fostering and maintaining a control environment which [would] ... enable directors and managers to rely on the corporate information system in fulfilling their responsibilities - not merely on preventing bribes (Williams 1980, p.42).

This section was viewed by Congressman Moss to be necessary in restoring confidence in corporate accountability. He stated the "accounting gimmicks" such as off-the book slush funds were indicated "to be part of the underlying problem" and would have been avoidable if corporations had effective internal control systems in place (United States 1977d, p.153). In other words, a system which is tested by independent auditors and assures shareholders of the protection of their assets (United States 1977d). However, this recommendation by the SEC based on the Oversight and Investigations Subcommittee and Congressman Moss

stop[ped] short of assuring necessary corollary protection: a requirement that independent accountants, who already must test management's system of internal controls for purposes of performing a valid independent audit, attest to the quality of the system of internal controls (United States 1976h, p.34).

Congressman Moss requested amendment to this section by adding a new subparagraph "requiring management's independent accountant ... to attest that management's internal controls are adequate to protect shareholders' assets" (United States 1977d, p.154).

The third paragraph was in relation to corporations' employees' actions, "directly or indirectly", in falsifying "any book, record, account or document ... for any accounting purposes". The SEC's aim was to prohibit "affirmative false statements" presented to auditors and shareholders, as well as failure in making, obtaining or creating "documents, necessary for proper accounting records" (United States 1976n, p.66). This addition to the Securities Law was based on the SEC's findings that the falsification of records was partly related to companies' accountants or external auditors who had not followed the leads or performed "their professional responsibility" (United States 1976m, p.550). This requirement was set in a way to "provide the basis for civil and criminal liability" and prosecution (United States 1976l, p.19).

The fourth paragraph was in relation to prohibiting "management from lying or deceiving its independent public accountant" (United States 1977d, p.154). It specifically stated that

[i]t shall be unlawful for any person, directly or indirectly

(A) to make, or cause to be made, a materially false or misleading statement, or



(B) to omit to state, or cause another person to omit to state, any material fact necessary in order to make statements made, in the light of the circumstances under which they were made, not misleading to an accountant in connection with any examination or audit of an issuer (United States 1976n, p.64).

However, Congressman Moss detected that the problem was also in relation to independence of outside accountants from management as was also detected by Metcalf in his study of the federal government's role in establishing accounting practices which was explained in chapter three. From his perspective, public accountants as independent assurers of the accuracy of the financial reports are to be primarily loyal to the shareholders, "whose assets are at stake", rather than management (United States 1977d, p.155), since the costs of their services are being paid from shareholders and investors' funds. He further argued, public accountant's responsibility

goes beyond ... [just] loyalty to the shareholder and his role of maintaining the confidence of public investors in the securities market. It goes to the heart of our economic system and the total society (United States 1977d, p.155).

He argued for an amendment of this paragraph by including a section

to provide that an independent public accountant who knowingly falsifies or contributes to the falsification of books and records or recklessly fails to ascertain all pertinent facts is suspended from participating before the SEC for at least some period (United States 1977d, p.154).

The third and fourth paragraphs took into account falsification by "aiding and abetting, and joint participation" (United States 1976n, p.66). Holton had concerns in relation to the wording of these paragraphs arguing that a court might hold a view "that negligent mistake in a book or record or a negligently made misstatement is a criminal violation" which could have the person going to jail for it (United States 1977d, p.159). However, in early 1977 these two paragraphs of the bill were issued as a series of rules by the SEC rather than being included in the network's legislation (Dundas & George 1979-

1980). The SEC subsequently adopted these paragraphs as “SEC rules specifically related to the recordkeeping provisions of the FCPA” (Lacey & George 1997-1998, p.135).

In addition, the SEC required corporations to establish audit committees comprised of independent directors “to work with outside auditors” to supplement this legislation (United States 1976n, p.67). This requirement came about from the SEC’s investigations of corporations’ books and records for illicit payments as well as a requirement of the bill proposed by Senator Church. It was revealed that some of these corporations had no audit committee or the committee was not fully independent of management, even though the SEC had advised corporations to establish an audit committee. Since the 1940’s<sup>52</sup>, the SEC required corporations to make “the role of the board of directors more meaningful and separat[e] the critical aspects of the functions of the board and independent counsel” (Schornack 1979; United States 1976n, p.67). However, these requirements were not part of the proposed bill as corporations, during the course of the voluntary program, were perceived to have already changed their governance and structures.

The SEC was confident that it would be adequate for the New York Stock Exchange (NYSE) to take action in this regard by modifying its policies and practices. The NYSE requirement for audit committees was modified to include the independence of their members from management and any “significant financial ties to the company”

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<sup>52</sup> In response to the McKesson and Robbins, Inc. investigation during 1940, the SEC recommended the establishment of audit committees by issuing Accounting Series Release No. 19 (Birkett 1986; Klein 2002; Securities and Exchange Commission 1940).

(Schornack 1979, p.73). Corporations were to commit to the Exchange's listing agreements and code of performance to be able to list their securities (United States 1976n). Hills, therefore, was "optimistic that this concept ... [would] be implemented" (United States 1977d, p.19) while the Oversight and Investigations Subcommittee perceived this action to be limited in its effectiveness (United States 1976h). This action was perceived by the SEC as a way of maintaining "the credibility of ... [the] system of corporate self regulation" (United States 1976n, p.B-30), the system which was established to protect investors and dependent on independent professionals such as auditors and outside directors (United States 1976f; United States 1977d). In addition, it would eliminate the "need for further direct government regulation" and set "an important example for other self-regulatory organizations" (United States 1976n, p.69).

The SEC's proposal, S.3418, from Senator William Proxmire's point of view, was "the weakest" of the proposals introduced to the Banking, Housing and Urban Affairs Senate on May 18, 1976. The record keeping requirement was advised by Sporkin, head of the SEC's Enforcement Division. The requirement was "a very simple one-line statute" and was suggested by him to Senator Proxmire as "all that was necessary" which Proxmire "was sceptical" about (Sporkin 1997, p.275). Professor John Burton<sup>53</sup> recommended the addition of the internal control provision, and Proxmire was "still not satisfied that such a seemingly benign-sounding provision would be effective" (Sporkin 1997, p.275).

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<sup>53</sup> Professor John Burton, was dean of the Columbia business school from 1982 to 1988. He was away from this position from 1972 until 1977, when he served as the chief accountant of the SEC.

The goal of the principal actor and network was not satisfied with the content and purpose of the bill and could have led to collapse of the existing network. As it was “merely codify[ing] the requirement that a corporation keep honest records, a requirement that is at least implicit in the entire system of corporate accountability” (United States 1976l, p.1). The proposal was based on the assumption that by requiring companies to accurately reflect all their transactions on the books and records of the company, including the questionable and illegal payments, corporate officials would be discouraged from becoming involved in such practices (Bathen 1978; Securities and Exchange Commission 1977). Hills argued that

[n]o accounting firm, no outside director, no lawyer, is going to risk his professional career, risk criminal penalties or civil litigation, simply to permit somebody to continue a questionable payment or practice. The important thing is that it gets disclosed (United States 1976m, p.549).

The SEC believed their program, that required disclosure of the facts, as detailed in chapter two, had in most cases changed the corporate behaviour which showed “the wisdom of ... [their] disclosure policy ... [as] a better alternative than direct regulation” (United States 1976l, p.25). S.3133 and S.3379 both required mandatory disclosure of all questionable foreign payments, while S.3418 had discarded the public disclosure requirement. S.3418 requirements demonstrated that the SEC was no longer the spokesperson and was becoming dissident. The bill relied on the SEC’s “authority under existing law” (United States 1976l, p.2) and not “forcing more disclosure than” the SEC required based on the materiality concept (United States 1976l, p.22). The disclosure system relied on maintaining “the integrity of the corporate books and records” and not distorting the self-regulation system (United States 1976l, p.15). Since in their view, while the problem was “serious and widespread” it was controllable and did not

“represent an inherent defect in ... [the] economic system” (Rubin 1976, p.622). Requirements of the two bills were anticipated by the SEC as “distorting the main thrust of ... [their] activities to do something else that ... [was] not ... perceived to be necessary” by the SEC (United States 1976l, p.15).

Due to Proxmire and some of the actors’ lack of support for S.3418 because of its shortcomings, the network was breaking down. Proxmire wanted to resolve the issue of illicit payment and to have the SEC enrolled in his network. His aim was to adjust the SEC’s weak bill. Since, the SEC was “spending a great deal of effort to put a finer point on a requirement that already exist[ed] while ignoring the more obvious need for new authority” (United States 1976l, p.19). These requirements were exercised before by the Commission, since its primary function was to develop “appropriate disclosure policies designed to assure ... investors have access to all material information relating to securities offered to them” (United States 1976m, p.510). Kennedy also was advocating the same view point that

[t]here was never a lack of law applicable to the situation. What there was, was a lack of law enforcement ... . This doesn’t mean that you shouldn’t have new laws, but your new law should be tailored to the genuine problem and not to the optical one (United States 1976l, p.178; United States 1977d, p.178).

From the SEC’s perspective, and contrary to Proxmire’s opinion, the then system of self-regulation that was well enforced by the Commission, as the most effective and efficient means of achieving corporate self-restraint in the marketplace, was adequate (Weismann 2008). This perspective was based on the SEC’s “regulatory philosophy ...

of corporate accountability via self-regulation” (Barbara et al. 2010, p.784). Hills claimed the SEC had

by any standard in the world, the most honest reporting system. ... We have eight major accounting firms and a number of smaller ones. We have every confidence and belief that those professional people are doing their job (United States 1976m, p.549).

The problem as perceived by the SEC was that the self-regulation system was frustrated. Therefore, with the adoption of S.3418 it was likely “to restore the damage done to the integrity of the system” as the SEC had “faith in the system of self-regulation that has existed all these years” (United States 1976l, p.4). The argument from the SEC was that the problem was around corporations who had “totally ignored the system” (United States 1976l, p.4) and believed self-regulation had “the potential significantly to enhance the reliability and accuracy of issuer financial reporting” (Securities and Exchange Commission 1977, p.11). As the system had also assisted the SEC in pursuing its voluntary program and requesting corporations to disclose their illicit payments.

Until then, as reported by Hills, the system had “worked remarkably well by any standard. It is the finest enforcement mechanism for business practice” (United States 1976l, p.15). While it was not “as draconian a fashion as other measures”, the SEC felt confident with their bill’s approach and were pushing for its approval (United States 1976l, p.11). It can be argued the S.3418 approach was potentially safeguarding and protecting the SEC and perhaps the accounting profession. As noted by Senator Proxmire, in a response to Hills “[y]ou see, what bothers me about that is, as you say,

you have faith in the system that it will work and I would like to have as much faith as I can; but the fact is it has not worked” (United States 1976l, p.6). Proxmire’s argument was related to the aftermath effect of the proposal, when the exposure on the illicit payments “dies down” (United States 1976l, p.6). When corporations and Government go back to their old ways of doing business and the lack of ability of the proposal to put an end to these payments. The argument was that self-regulation was insufficient to curb corrupt practices as company managers believed that there was a need to pay bribes to remain competitive or to conduct business.

The S.3418 requirements, conflicting with Proxmire’s proposed solution, were designed in a way to encourage the private sector to correct the problem, with SEC supervision, and without Government involvement in business practices. It was “the least costly way of attacking the problem” by relying on “a flexible materiality concept” to have corporations meeting “a responsible standard as determined by the society around them” (United States 1976l, p.12). The securities law already had a rule in place to disclose material payments by asking corporations for honest records, and it would be in their best interest to disclose the illicit payments “so people realize that a company is not one of the ‘bad guys’” as argued by Evans, the SEC’s then commissioner (United States 1976l, p.12). Nonetheless, Proxmire argued for enactment of legislation that went further than the SEC’s proposal which was investor protection and disclosure of material facts (United States 1976l). As part of the ‘Corporate Rights and Responsibilities’ hearings, Professor Stevenson from George Washington University, expressed the same views as Proxmire that the SEC requires “to expand their disclosure

requirements to take care of other social problems” rather than just protecting investors (United States 1976f, p.422).

### 3. The Outcome of the Above Hearings

After all the representations made by different actors at the Senate Committee on Banking, Housing and Urban Affairs on the above bills, and failure of the Proxmire network, the committee met in June 1976 (U.S. Senate 1977) and “agreed to report a clean bill”<sup>54</sup> by Senator Proxmire, S. 3664<sup>55</sup>, to the Senate in July 1976 (United States 1976p, p.30). The bill was a combination of the S. 3313, S. 3379 and S. 3418 bills which, based on Proxmire’s speech on the senate floor, was “a compromise bill ... [and t]he disclosure provision was dropped” to which Proxmire objected (United States 1976e, p.30332). Senator Tower<sup>56</sup>, in addition stated that the SEC’s bill when it was presented to the Senate committee, “no private witnesses” testified other than the SEC Commissioners and Chairman (United States 1976e, p.30332). He further on argued that while the SEC’s proposal was favourably reported, the nature of the proposal raised

serious questions ... . Questions have also been raised as to the advisability of making it a crime to orally lie to or to mislead an auditor. It is contended that the actual effect may be to reduce the effectiveness of the independent auditing process (United States 1976e, p.30332).

By reporting S. 3664, Proxmire had initiated a new network to resolve the issue of questionable payments as well as enrolling the SEC as the spokesperson. The new

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<sup>54</sup> Based on the glossary of Congressional terms, a clean bill is “a bill which has been revised in mark-up. Amendments are assembled with unchanged language and the bill is referred to the floor with a new number” (<http://innovation.cq.com/media/congressional-glossary?ref=CQ>).

<sup>55</sup> Senator Proxmire had introduced S. 3664 to the Senate.

<sup>56</sup> John Goodwin Tower was Republican senator from Texas. He was assigned to the Senate Committee on Banking, Housing, and Urban Affairs.



network was being established on the grounds of Proxmire's compromises and divergence to a weaker proposed bill by the SEC, S. 3664. The SEC bill had disregarded most of the provisions in S. 3379 and S. 3133. In this regard, the accounting provision of the new bill incorporated almost "verbatim all of S. 3418" (United States 1976g, p.2). This was partly due to Proxmire's interest in continuation of the SEC's enrolment in his new network, even though the above arguments in relation to S. 3418 demonstrate its shortcomings.

It appears Proxmire had capitulated. Nonetheless, the electorate could perceive Proxmire's approval of even a weakened bill as doing something constructive for society and, thereby, achieving his original goal of legislation addressing illicit payments. In forming the new network, however, Proxmire was facing difficulties. As will be illustrated, Proxmire was in favour of strengthening S. 3664, by adding Senator Church's amendment that was presented on the Senate floor. The amendment was based on the disclosure requirement of the Church bill which was similar to Proxmire's original bill as well as establishment of audit committees with independent members. Ultimately, the accounting provision, did not include requirements pertaining to audit committees, even though questionable payments were seen as "symptoms of weak corporate accountability and governance mechanisms" (Goelzer 1979, p.6). The SEC then Executive Assistant chairman, Goelzer, argued that "the concepts of ... independent audit committees are inherent in the accounting provisions" (Goelzer 1979, p.12).

The disclosure requirement amendment focused on routine report and “disclosure of fees and payments to insure that information with respect to questionable payments by ... corporations” are available to the Congress and shareholders (United States 1976e, p.30334). Church claimed that this requirement was already accepted by the Congress and the President as part of the Arms Sales Act. The disclosure statement amendment would have complemented and strengthened Proxmire’s bill, as the reporting requirement was “the teeth that would make this reform bill effective” (United States 1976d; United States 1976e, p.30421). In his judgement “[a] wider application of the disclosure provision is ... necessary to make this bill do the job that ... Senator Proxmire wishes it to do” (United States 1976e, p.30334). While the amendments were strongly supported by Senator Proxmire as “a logical and sensible supplement”, it was defeated by Senator Tower, the Department of State, the SEC and Secretary Richardson, the Chairman of Ford’s Task Force (United States 1976d; United States 1976e, p.30334).

On the Senate floor during September 14 and 15, these actors had the common goal of persuading other Senators and actors that S.3664 and the SEC’s recommendation was the best solution to the problem of questionable payments and that there was no need to add a disclosure requirement to the bill. Senator Tower asked for a critical analysis of the content of the amendment and stated “the Senate appears to be once again embarked on a course of legislating first and asking questions later” (United States 1976d, p.30419). Richardson, also argued that the disclosure requirement “could create a serious paperwork burden for both American business and for the Securities and Exchange Commission” (United States 1976d, p.30419). While the amendment

language clearly gave the SEC “the discretion necessary to eliminate the need to report minutiae” (United States 1976d, p.30421). Hills, the SEC chairman, in a letter to Tower raised his concerns stating,

[t]hat such an amendment which impacts so significantly on the Commission’s work should be considered at this time and in a manner inconsistent with the careful approach of the Senate Committee on Banking, Housing and Urban Affairs in its consideration of S. 3664 is a matter of gravest concern (United States 1976d, p.30420).

Hills believed that in the long term, the lessons will be learned and

the new mechanisms of corporate accountability which have resulted in the judgement of the Commission [would] serve to strengthen the quality of corporate management, public confidence in the business community and the integrity of ... [the] Nation’s capital markets (United States 1976d, p.30420).

Proxmire argued this addition would be “a substantial strengthening and improvement of the bill” (United States 1976e, p.30332). Church concluded that “[i]f we want to get to the root of this problem, we must require these companies to disclose publicly the fees and commissions they pay to their agents abroad” (United States 1976d, p.30421). The proposal, however, was argued by Hills to be significantly departing “from the traditional flexibility of the federal securities laws” (United States 1976d, p.30420). Tower believed that the amendments were “well–motivated” but would have “far-reaching implications not just for American businesses that are doing business abroad but also it could have some foreign policy implications” (United States 1976e, p.30335). Tower felt as the matter was important it was not sufficient to just spend a few minutes on the Senate floor, but to hold hearings and debates on this issue to provide other Senators with an opportunity to consider the proposal in the legislative process (United States 1976d; United States 1976e).

Hills, the key actor in Senator Proxmire's network, did not approve of the addition of the disclosure statement amendment introduced on the Senate floor by Senator Church. The addition of a detailed statement in relation to corporations' contributions as part of S. 3644, was stated by Hills to be constraining the SEC "to urge that the President veto the legislation" (United States 1976d, p.30420). In other words, if the bill including the amendment was enacted, the SEC would lobby the President to veto the entire bill. If the SEC was successful, Proxmire's initial goal would not be achieved. Percy, an actor of Church's network, also supported S. 3664 without any amendment, since it could "stand on its own feet, will be supported, and ... will be signed by the President" (United States 1976d, p.30424). Accordingly, the amendments were dropped due to its complexity, the possibility of placing "an intolerable burden on American business" and Proxmire's desire to continue the existence of his new network **Bill To Ban Overseas** (Bill To Ban Overseas Corporate Bribes Dies 1977; cited in The Committee on Corporate Law and Accounting 1978, p.333; United States 1976e).

The transcript of the meeting about formation of S. 3664 was not published for public distribution (The Committee on Corporate Law and Accounting 1978, p.331). This represented a lack of transparency surrounding the new proposed bill and Proxmire's change of heart. There was a perceived "broad consensus in the Senate on this issue" and the proposed solution by the SEC and Proxmire (United States 1977g, p.167). However, Tower expressed his concern regarding the committee acting in "such haste" and "that the internal accounting controls provisions though laudatory in concept may prove troublesome in its implementation" and raises questions about its ability to

“significantly contribute to resolving the bribery dilemma” (United States 1976e, p.30332). Senator Church also argued if S. 3664 was

really sufficient to provide a remedy for this immense amount of corruption ... we could be sure that this place would be buzzing with lobbyists. They are not concerned about this bill. They have no reason to be concerned about it. That is why these corridors are not filled with the lobbyists of any companies coming here to tell us that we must not pass this bill (cited in Siedel 1981, p. 450).

Despite the above criticism and Proxmire’s attempt to strengthen the bill, the new network was intact. By September 15, the Senate passed the bill without any amendments and the bill “was referred to the House [of Representatives] Committee on Interstate and Foreign Commerce” (United States 1976p, p.30). The SEC was successful in persuading actors of the Proxmire network to pass the bill. Proxmire was defeated in his attempt, but managed to avoid the new network from falling apart again in its initial stage. As S. 3664 was identical to the House of Representatives bill, H.R. 15481, the details of the sections of the bill are explained in the following section.

### 3.1 Congressman John Murphy’s Bill

Bill H.R. 15481 was introduced to the House of Representatives Committee on Interstate and Foreign Commerce in September 1976. Section one of the bill was similar to S.3418 amending the Securities Exchange Act of 1934 since it required “reporting companies to create and to maintain accurate books and records” as well as establishment of

internal accounting controls sufficient to assure that transactions will be executed in accordance with management’s instructions, that transactions will be accurately recorded, that access to corporate assets is carefully controlled,

and that the representations on company books will be compared at reasonable intervals with actual assets, and any discrepancies resolved (United States 1977d, p.2-3).

The first section, as is evident, was identical to the four requirements of S.3418. Neither the language nor any of the provisions were changed by the Senate or the House, after several hearings were held in this regard. The SEC's then chairman, Hills, as the spokesperson of Proxmire's new network had appeared at this House of Representatives hearing to persuade and recruit other actors to assume roles in the network as well as seeking continued support for their underlying goal. During his testimony regarding this section, Hills expressed his satisfaction with the bill as it provided "correction of the system" that had led to "failure in corporate accountability" (United States 1977d, p.18). He further on said, "[t]he lesson to be learned ... [was] that increased corporate accountability to the board of directors and to stockholders will strengthen quality and morality of corporate management" (United States 1977d, p.20). Accordingly, the passage of the legislation that was weakened by the SEC and Proxmire, was urged by the SEC.

Hills's flowery speech, on behalf of Proxmire's network, favouring the legislation, pointed to the "extraordinarily effective enforcement record of the Commission staff" throughout their voluntary program and how their enforcement would favour this approach (United States 1977d, p.18). The newly proposed legislation was preferable to "tougher and stronger laws" which were proposed by commentators and members of the Congress, who were concerned by the public and the press losing interest "in the matter of corporate bribery" (United States 1977d, p.22). Upon enactment of the legislation, it would "demonstrate a strong affirmative congressional endorsement of the need for

accurate corporate records and effective internal control measures and of the unacceptability of deception or obstruction of auditors” even though public witnesses or some of the senators had argued otherwise (United States 1977d, p.18).

Members of the Federal Regulation of Securities Committee of the American Bar Association (ABA) had “grave concern about H.R. 15481” as it was drafted (The Committee on Federal Regulation of Securities 1977, p1903). Congressman Murphy questioned the internal control requirement since in reference to the SEC’s experience the problem was not “lack of adequate internal accounting systems, but ... rather, the circumvention of adequate, or seemingly adequate systems” (United States 1977d, p.25). The chairman of the committee on SEC regulations of the AICPA, Holton<sup>57</sup>, in his testimony argued that from careful analysis of illicit payment cases, it was clear most of the companies had great internal control systems in place, at least on paper (United States 1977d). Accordingly, corporate governance practices which were defined by the state corporation law, had proven to be inadequate, in promoting ethical corporate behaviour (Hohenstein 2009).

Holton, also, had the same concern with the wording of section B. Since the wording was not explaining a “definitive standard ... to judge what is or is not an adequate system” among accountants and independent auditors (United States 1977d, p.158). It was not assuring that the root of the problem was going to be removed. The word adequate was “much like ‘beauty’: for the most part, it is only in the eyes of the beholder” (United States 1977d, p.158). Holton stated, most corporations had internal control systems in place and the issue was

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<sup>57</sup> Represented the AICPA and testified on the proposed House of Representatives bill during September 1976 hearing.

that illegal or improper corporate activities can and will occur regardless of the strength of internal accounting controls, because no system has yet been devised that can withstand collusive behavior or circumvention by corporate officials (United States 1977d, p.158).

Nevertheless the SEC chairman, along with Proxmire's network, insisted on passage of the bill "in its present form" and without any changes to section one (United States 1977d, p.30), even though the requirement was insufficient to fulfil the objectives of the bill. Proxmire wanted to speed the action of Congress on this bill and avoid the bill going through the lengthy process of being presented at the House of Representative's hearing (United States 1976d). He proposed to link his bill "as an amendment to a minor House-Senate conference group" that was already passed by the House (United States 1976d; Wall Street Journal Staff Reporter 1976, p.7). However, this was rejected by Senator Tower on the Senate floor as he was certain that the House of Representatives were able to "pass the bill before adjournment" (Bill To Ban Overseas Corporate Bribes Dies 1977; Wall Street Journal Staff Reporter 1976, p.7). The above arguments demonstrate the ability of this network's spokesperson and partly its actors in using effective language and methods in persuading others that their bill was the only solution to the problem of lack of disclosure and accountability of management to the issue of illicit payments.

The other two sections of H.R. 15481 were in relation to payments made to foreign or domestic officials. These sections were mainly similar to S.3313 related provisions. The bill also included criminal penalties which were only "up to 2 years imprisonment and [or] a fine of up to \$10,000" (United States 1977d, p.3). The amount of fine was alleged by Eckhardt as being "not much punishment to a corporation that is going to make a billion" (United States 1977d, p.149). While the SEC was in agreement with these



sections, it stated their preference of not being “involved even in the civil enforcement” as “disclosure is a sufficient deterrent to the improper activities ... concerned” (United States 1977d, p.20).

The bill was presented to the House towards the closing session of the Congress and during the last hearing held by the House. The Massachusetts member of House of Representatives, Harrington, feared the rush of the House for passage of the bill “as if it were a definitive solution and total absolution of American corporations and this Congress from any further responsibility for corrupt business practices” (United States 1977d, p.144). He argued that the Congress has “let the illusion of action substitute for dealing substantively with problems in a more meaningful way” (United States 1977d, p.148). Congressman Moss felt similarly about the delay of the approval of the bill until the next Congress since the proposal needed more changes and amendments to fully achieve its objective of protecting shareholders’ assets (United States 1977d).

### 3.2 The Task Force Bill

As argued in chapter four, the task force, as Ford’s network, was mainly in favour of an international treaty which was aligned with President Ford’s efforts. In a letter to Senator Proxmire as well as testifying in different hearings, the task force had outlined their thoughts on the bills that were presented to the Senate and House, as discussed above. From their point of view the problem was “too serious to settle for what might be a passing symbolic gesture” (United States 1977d, p.82). In addition, the private sector

had the “basic responsibility to come to grips with this problem themselves” (United States 1977d, p.85).

In relation to S. 3133, Proxmire’s previous network’s solution, the task force “unanimously” rejected this bill as it included a “disclosure-plus-criminalization scheme” (United States 1976l, p.61). The Ford network was distancing itself from the other networks such as Proxmire or Church by arguing that the problem was a diplomatic problem (McManis 1976). This was probably their strategy in strengthening the network, as well as enrolling new actors to their network. In their opinion, the two approaches could not “be compatibly joined” (United States 1976l, p.61). Also, they had “rejected the approach of direct, unilateral criminalization under U.S. law of corrupt payments made abroad, the approach ... contained in H.R. 15481” and the identical bill that was adopted by the Senate (United States 1977d, p.32). The rejection was based on the problem of “lack of enforceability” of the provisions of the bills domestically and mainly internationally (United States 1977d, p.107).

The task force was in favour of the disclosure approach albeit “flat criminal prohibition” would pressure corporations to resist questionable payments (United States 1977d, p.109). Harrington was distressed that the Congress and the task force had been debating the criminal or disclosure approach, while paying “little attention ... to what lies at the heart of the entire issue: Public confidence in our national institutions” and principles (United States 1977d, p.144). Eckhardt also agreed that the solution was not just to enact new legislation but mainly the enforcement of new or existing legislation. Introducing new legislation from his point of view was “a means of simply brushing the

question under the rug without future oversight respecting the agencies” in charge of enforcing the legislation (United States 1977d, p.151).

So the task force rejected the proposed bills as “such legislation would represent the most forceful possible rhetorical assertion by the President and the Congress of our abhorrence of such conduct” (United States 1976l, p.61; United States 1977d, p.32). Also, they felt that there would be difficulties with enforcing such legislation as prosecutions of the issue involved investigations in other countries resulting in possible resistance rather than assistance from these countries. The same case was argued to be possible in the U.S. in relation to limited access to “key witnesses or documents” which would “preclude proof beyond a reasonable doubt” (United States 1977d, p.33). The President had opposed this approach “as essentially unenforceable, legislation which would seek broad criminal proscription of improper payments made in foreign jurisdictions” (United States 1976l, p.63). Accordingly the task force opposed “unilateral criminal prosecution [which] would represent little more than a rhetorical assertion” (United States 1977d, p.33). In this regard, the task force urged the Congress “not to substitute tokenism for real action to deal with the questionable payments problem” which would lead to Congress washing “its hands of an important problem without having taken meaningful, enforceable action” (United States 1977d, p.33).

To validate their network, the task force was supporting the new legislation such as the SEC’s proposal, that would “require more systematic and informative reporting and disclosure” than what was included in S.3133 or S. 3664. It was perceived that requiring corporations to prepare “additional disclosure[s]” such as “the name of the payee” was

putting a burden on “American businesses” (United States 1976l, p.62). Taking into account the above arguments, with the direction of the President the task force had drafted legislation focusing on “full and systematic reporting and disclosure of payments made by American businesses” (United States 1976l, p.63). In August 1976 the task force developed two bills, S. 3741 and H.R. 15149, both called the Foreign Payments Disclosure Act. The bills were based on a disclosure approach “with appropriate seriousness ... [to] the role of law itself as a positive force in the domestic and international community” (Rocco 1999; United States 1977d, p.82). Greanias and Windsor (1982, p.59) stated that the task force bills “thanks to Secretary of State Henry Kissinger, included a strong measure of *realpolitik*”. The bills were designed

to deter improper payments in international commerce by American corporations and their officers ... to encourage foreign nations to enforce their own criminal laws against official bribery and corruption; and to set a forceful example to ... [their] trading partners and competitors regarding the imperative need to end improper payments (United States 1977d, p.33).

The Secretary of Commerce under the provisions of the bill would have had the authority to enforce and promulgate rules and regulations of the act while not “affecting or conditioning the authority of the Securities and Exchange Commission” (United States 1977d, p.63). It would have authorised the Department of Commerce not to disclose the facts to the public until one year had elapsed, for the reason of national interest. This meant the bill was proposing another type of cover-up by the Government while Watergate scandals were mainly about this same issue.

The network was not successful in moving from problematisation to the next translation moment, since the bills until mid-1976 “were not considered in hearings in either the

Senate or in the House” (Bill To Ban Overseas Corporate Bribes Dies 1977; Dardess 1979, p.638; United States 1977d; United States 1977f). One reason was that the bill was presented late in the year which was around the time when congressional sessions were closing and the presidential election was approaching. The other reason was that the Senate had already endorsed the Proxmire bill, S. 3664 and was reluctant “to reverse course” as Proxmire’s network was successful in capturing, enrolling and interesting a majority of the Senators as the actors of their newly established network (United States 1977d, p.83). As well as bringing actors together and consequently helping in diminishing the threat of predators and actors from other networks. Senator Proxmire was successful in making his network indispensable and assuring the vitality and triumph of the translation process.

The task force chairman presented the bills to the Consumer Protection and Finance Subcommittee by September urging the “Congress not [to] act in haste to adopt an essentially rhetorical, token solution in lieu of the more meaningful proposals put forth by President Ford” and the task force (United States 1977d, p.34). Not everyone was in agreement with this statement. For example Congressman Moss stated that “H.R. 15481 ... [was] far superior to the administration’s proposal” concerning safeguarding of shareholders assets (United States 1977d, p.155). As well as the ability of the Department of Commerce in conducting its duties based on the proposed bill by the task force. The Moss Subcommittee’s experience with the Department was that it had implicitly condoned activities which were “against national policy or simply by looking the other way” (United States 1977d, p.156). Consequently, Ford’s network and his bills were defeated by the Senate and the House. This was partly because Carter was winning

the election and driving Ford to side step the illicit payment issues and mainly serving on corporate boards. He had no incentive to re-establish his network in 1977, when the new Congress was in full swing.

#### **4. Conclusion**

The bills presented to the Senate or the House of Representatives were either supporting the disclosure or criminalisation approach or both. Proxmire's bill was favoured by those who wanted to make bribery illegal in the U.S. as it would deter the practice. Alternatively, Church was in favour of disclosure of the details of illicit payments. Consequently, Proxmire's approach prevailed in the Senate which became the main vehicle for the passage of the FCPA (Colby 2013). The criminalisation approach was mainly resisted in the Congress and by witnesses. By the closing session of the Congress in 1976, two distinct bills were outstanding. One was the Senate bill "incorporating verbatim all of the SEC's legislative proposal and including a direct criminal prohibition against foreign bribery" (United States 1977d, p.207). The other one was the administration's bill which only included disclosure requirements and was defeated by the Congress.

The senate bill was passed in the Senate, but died in the House of Representatives as the work on this bill was not completed prior to adjournment of the Congress. Accordingly, as will be argued in the next chapter, the only bill that was reintroduced to the Senate and the House of Representatives during 1977 congressional hearings was an identical bill to S. 3664. As per the translation model, Proxmire was the only primary actor

successful in keeping his network together and persuading the other actors that his bill was the only solution. The following chapter will focus only on the Proxmire network and the ability of this network in contesting criticisms about their proposed bill and finally enacting it as the Foreign Corrupt Practices Act.

# Section III

The previous two sections detail the political events that led to the formulation of legislation condemning corruption and bribery. Section III aims at demonstrating that not only was the enactment of the FCPA controversial, but so too were the enforcement.



# Chapter Six: The Foreign Corrupt Practices Act

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*Corruption charges! ... Corruption is government intrusion into market deficiencies in the form of regulations ... We have laws against it precisely so we can get away with it. Corruption is our protection. Corruption is why we win (cited in Biegelman & Biegelman 2010, p.1)*

As demonstrated in previous chapters and in the context of ANT, the FCPA was “the child of political scandal” (Gary 1990, p.12). The act was prompted by a series of scandals including Watergate involving bribery of domestic and foreign governments, politicians and corporations that had raised concerns about the integrity of the U.S. business community (Darrough 2010; Gary 1990) and for some, existing suspicions were confirmed (Securities and Exchange Commission 1981a, p.6). As detailed in chapter four, the scandals took place during a time when bribery and illicit payments were prohibited by law in the U.S. and other countries such as France and Germany. The laws in place, however, lacked enforcement, precision and coherence, as it was full of loopholes” (United States 1971, p.114).

The Congress was compelled to respond to the events that had unfolded and shaken public confidence and trust in the integrity of the free enterprise system. The FCPA allowed Congress to demonstrate a commitment to ensuring the integrity of U.S. corporations. Integrity according to Clausen, President of the Bank of America:

Is not some impractical notion dreamed up by naïve do-gooders. Our integrity is the foundation for, the very basis of our ability to do business. If the market

economy ever goes under our favourite villains, socialist economies and government regulators, won't be to blame. We will (cited in United States 1977d, p.2).

Senator William Proxmire<sup>58</sup> (United States 1976l, p. 3) argued “the fact that so many companies have been able to elude the system of corporate accountability strikes us as a matter requiring significant action”. As discussed in chapters two, four and five, a series of hearings in response to these scandals were held. The evidence given at these hearings, made it obvious that legislation, as the preferred solution by the principal actors’ of the networks, was required to address corrupt activities. The principal actors were successful in minimising the effect of outside actors who did not believe in the favoured solution. The proposed bills were not “officially opposed” by the business community, as outside actors to Proxmire’s network, since they did not want “to be heard opposing legislation which seemed to support all the best elements of morality” (Bialkin & Atkeson 1979, p.625). The Chamber of Commerce, also as one of the outside actors, for instance, was “not convinced that new legislation is needed to confront the problem caused by questionable overseas business payments” (United States 1977g, p.235). The need for this piece of legislation was apparent as “evidence of questionable payments ... [had] become so voluminous ... that the American public ... [was] becoming immune to the serious issue of corporate performance and public policy” (United States 1977g, p.25). Also, questionable payment disclosures concerning corporations were “no longer front page news” and had been downgraded to “other news columns of the business sections of even the most thorough papers” (United States 1977g, p.25).

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<sup>58</sup> A primary author of the original Act

There were differences in the content of the bills presented by each of the networks assumed for purposes of this study, to the Senate and House of Representatives. As previously argued, the bills either supported the disclosure or criminalisation approach or both, depending on the principal actor's aim and goal. Actors in President Ford's network for instance, shared a view point that was different to the congressional activist in relation to enacting a law that required only disclosure and not prohibiting payments outright (Greanias & Windsor 1982). However, Ford and his network were "moving at a snail's pace to put a stop to bribes overseas by American corporations" (Journal Washington Bureau 1976, p.2).

By the closing session of the ninety-fourth Congress, the division between the White House and the Congress led to failure in passage of remedial legislation (Greanias & Windsor 1982). This chapter will explain the bills that were presented and supported by Proxmire's newly constructed network during 1977 that led to passage of the FCPA. This chapter will explain in more detail the influence of the SEC on the proposed bills and Proxmire as the principal actor leading to approval of the Senate bill with "very little floor debate" (Bialkin & Atkeson 1979, p.626). The SEC was able to influence the accounting provisions of the bill even though these provisions were viewed as only requiring corporations to keep honest books and records (United States 1976). The Commission stated

[t]he prevention of fraud and the altering of corporate conduct are necessary consequences of "disclosure" as a regulatory technique. This effect of the disclosure concept is one reason it was chosen as the means to protect investors. ... Nonetheless, the committee does not believe that disclosure requirements should be imposed, regardless of the materiality of the information to be elicited, because of the effect they will have on corporate conduct (United States 1977e, p.318-319).

For this reason, it can be argued, the bills had taken “a cautious approach to this immense problem” (United States 1977g, p.28).

## 1. New Congress but the Same Old Mentality

By March 1977, Senator Proxmire along with Senator Harrison Williams<sup>59</sup>, as a new member of Proxmire’s network, had introduced S.305 to the Senate Committee on Banking, Housing, and Urban Affairs to keep the network viable. The bill was described as providing “one answer” to the problem of illicit payments made by “any corporate officer or employee of any corporation ... to bribe a foreign government official to obtain business or to affect the outcome of legislation or regulation of that Government” (United States 1977c, p.2). Senator Proxmire during his opening statement said “[l]et’s not kid ourselves. This bill is not home free. It was stopped last year in the House by the opposition of those objecting to the provisions of the bill” (United States 1977c, p.2).

The aims of the bill were supported by the newly enrolled actor, the Carter Administration, since they believed in the need for “strong government action in the form of ... [new] legislation” (United States 1977c, p.67). The re-established network successfully being at its mobilisation stage, needed “strong support from the administration” and the ones in the Congress who believed in getting the bill passed (United States 1977c, p.2). Along the same line, the Administration as well did not want to either weaken “the thrust of the bill” (United States 1977c, p.71) or delay the passage

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<sup>59</sup> Senator Williams was Democrat and during 1977, was part of the Committee on Banking, and Urban Affairs.

of the bill. They wanted to support and enact a bill that was enforceable and effective domestically and internationally. The disclosure requirement was perceived to outweigh its burdens as it provided a “highly effective deterrent” mechanism (United States 1977c, p.72). The administration was concerned with the enforcement of provisions of S. 305 by the SEC as it was drafted, since the primary responsibility of the SEC was “securing adequate disclosure to protect investors of registered securities” (United States 1977c, p.71).

### 1.1 Details of S.305 Bill

The bill comprised two titles. Title I, the foreign corrupt practices was an exact replica of S. 3664 which consisted of the accounting provisions pertaining to internal control systems and integrity of corporations’ books and records. The accounting provisions of S. 305 were not modified or changed based on the AICPA recommendations made during the hearing held in relation to H.R. 15481 in 1976, as was detailed in chapter five. Title II called the disclosure, was in relation to determination of ownership and controlling percentage of investors and shareholders in a U.S. corporation (United States 1977c). The provision required corporations to report “additional information concerning the residence, nationality and nature of beneficial ownership” (United States 1977c, p.2). This title was an addition to the Domestic and Foreign Investment Improved Disclosure Act due to “dramatic growth in foreign investment in the United States in recent years” (United States 1977c, p.2). The majority of the discussions during the hearing held for S. 305 was in relation to this title, since the first title was already passed by the Senate in 1976 and Proxmire’s newly built network was based on title I. However, title II was dropped out of S. 305 due to wide-ranging disagreements

by the witnesses such as Senator Metcalf and the then Secretary of the Treasury at the Senate hearing regarding its effectiveness.

The recommendations by the AICPA in relation to title I, as explained in chapter five and later on in this chapter, were pertaining to identified “deficiencies in the proposed statutory language ... to make the legislation effective” (United States 1977c, p.225). A similar comment was submitted to the Senate by Price Waterhouse and Co requesting a change in the wording of this provision. The chairperson of the Ad Hoc Committee on Foreign Payments<sup>60</sup>, Von Mehren, also stated that the accounting provision was broad, “so general and vague” that if enforced in this fashion would “be of little practical use in implementing the intended objective” (United States 1977g, p.121). The proposed bill did not “furnish any additional protection against wilful circumvention” (United States 1977g, p.96). He further argued that the problem was in relation to corporations “deliberately and intentionally” disregarding and circumventing their internal control systems and not about existence of the system (United States 1977g, p.96).

The cases, such as Gulf Oil Corporation that is briefly explained in chapters two and four, represent this issue. The language of this provision appeared “to be mere jargon” and for it to be useful and effective there was a need for further definition (United States 1977g, p.122). Nonetheless, these suggestions as well as the ones by the AICPA during their testimony in the 1976 hearing, as explained briefly in chapter five, were not promulgated by the SEC or Proxmire when the bill was reintroduced as S.305 (United

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<sup>60</sup> The committee was established in 1975, at the suggestion of the then President to prepare a report in relation to the problem of questionable payments (United States 1977g, p.62).

States 1977c). From the translation model, it can be argued that the SEC as the spokesperson was able to obtain the trust and confidence of the network's actors regarding the language of their solution and to be able to exclude the accounting profession from their network.

Williams, as the then newly appointed SEC chairman in April 1977, testified in relation to the accounting profession's criticism of the accounting provisions, during the House of Representatives hearing in 1977 to guarantee the validity of Proxmire's network in the Congress. For instance, Williams argued that the objection to the use of the term 'accuracy' was "somewhat perplexing in light of the fact that the IRS presumably expects that the same information be "accurately" reflected in corporate tax returns" since the term did not mean "exact precision as measured by some abstract principle" (United States 1977g, p.220). The accounting provisions were viewed by the SEC as a way of creating "a climate which would significantly discourage repetition of the serious abuses" while "not directed solely to the problem of questionable or illegal corporate payments and practices" (Securities and Exchange Commission 1977, p.1). His testimony also, assured the enrolment and mobilisation of the network between newly enrolled actors during 1977.

## 1.2 The Bills Presented to the House of Representatives

Out of the bills presented to the House of Representatives in 1977, Eckhardt's bill, H.R. 3815, House of Representatives counterpart of S. 305, called the Unlawful Corporate Payments Act, was the one that was primarily debated. H.R. 3815 was solely taking a

criminalisation approach which differed from the S. 305 dual approach of disclosure and criminalisation (Rocco 1999). The bill's aims were supported and favoured by the Department of State and the Carter Administration, as Proxmire's new spokesperson. Enactment of the bill was recommended by both after implementation of their proposed changes to the wording of the bill and expansion of its scope.

The other bill presented, H.R. 7543, had adopted a disclosure approach to the foreign bribery problem. It was in relation to the establishment of an "Office of Foreign Business Practices within the Department of Commerce" (United States 1977b, p.7) to take the responsibility of educating and informing multinational corporations "with respect to proper foreign business practices" (United States 1977b, p.36). Eckhardt stated "[d]isclosure can never be an effective deterrent so long as the anticipated benefit of making a bribe, such as winning a multimillion-dollar contract, exceeds the adverse effect" (United States 1977b, p.9). The bill was taking the enforcement authority and the ability to investigate the corporations' books and records from the SEC, and transferring it to a new body under the Department of Commerce.

The new body was to handle "paperwork and enforce the sanctions for failure to disclose" (United States 1977b, p.10). The SEC had already proven its expertise in this area as they were able to "track down the misuse of funds through corporate accounting procedures [which] is an extremely important tool of enforcement that virtually no other agency has any experience in" (United States 1977b, p.13). Eckhardt was also in disagreement with this body, since in comparison, the SEC had "an unmatched reputation for political independence in its enforcement efforts" and was "likely to be



more immunized from political influences than other departments of the executive branch” (United States 1977b, p.10). Partly due to the above reasons and other shortcomings of the bill, it was nevertheless, not passed by the House of Representatives.

The Carter Administration favoured H.R. 3815 as some of their recommendations pertaining to S. 305 were dealt with in this bill. From the point of view of the Department of State, this bill along with the existing law and regulations were to “provide an effective framework for dealing with the problem of foreign bribery by U.S. firms” (United States 1977b, p.7). The other reason was that this bill was similar to part of S. 305 which made “it a crime under U.S. law for domestic concerns to use bribes of foreign officials in furtherance of U.S. commerce” (United States 1977b, p.7). The slight difference between these bills was that the House version “extended coverage to United States-controlled foreign subsidiaries” (Lesser 1979b, p.168; United States 1977g).

H.R. 3815 was based on the criminalisation approach which was perceived to be “the most effective deterrent, the least burdensome on business and no more difficult to enforce than disclosure” (United States 1977b, p.9). The argument made in the House was since “foreign bribery is a reprehensible activity, it should be outlawed rather than legalized through disclosure” (United States 1977b, p.9). Accordingly, the accounting section of S. 305 or preceding senate bills were excluded from this bill. The bill was mainly in relation to dealing with the crime itself rather than relevant accounting provisions. These requirements were “strongly opposed by the accounting industry as

going far beyond the question of protecting against foreign bribery” (United States 1977b, p.13).

The House bill, HR. 3815 was mainly rejected by the witnesses during the hearings held on the bill. A common argument was the criminalisation approach on which the bill was based, was perceived to be ineffective in its enforcement, prosecution, and counterproductive. The SEC, representing and promoting the Proxmire network, favoured the Senate bill as H.R. 3815 prohibited certain payments to foreign officials that were “designed to proscribe ... conduct which is not supported in our society and tends to erode not only ethical standards but the free, competitive and effective marketplace” (United States 1977g, p.196). Recommendations of Moss and the then SEC chairman, Williams<sup>61</sup>, as advocates of the Proxmire network, accordingly were the addition of the accounting provisions, disclosure approach, into this bill to be acceptable and effective. They were both more in favour of the provisions embodied in H.R. 1602 and S. 305 than HR. 3815, which was introduced in January 1977 by Congressmen Murphy and Solarz. H.R. 1602 was in favour as it was in agreement with the Proxmire network’s goal, of prohibiting bribery by increasing corporations’ accountability to their stakeholders, and identical to title I of S.305 which was already approved by the Senate. The SEC’s new chairman supported this bill, as he “was willing to have the SEC undertake criminal-enforcement responsibilities under the new law” (Greanias & Windsor 1982, p.71).

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<sup>61</sup> Harold Williams became the chairman of the SEC by April 1977. He served as the chairman from 1977 to 1981.

Proxmire, by agreeing to the SEC's recommendations and compromising his proposed bill, was successful in mobilising the actors of his network. They were now representatives of their network. The actors were seeking support and alliances in the Congress by demonstrating the shortcomings of the proposed bills in the House of Representatives. For instance, in relation to H.R. 3815, Moss stated that the bill only held "American business to a higher standard of conduct by prohibiting outright bribes" without eliminating or discouraging "American corporate interference in the political or economic affairs of foreign countries" (United States 1977g, p.167). Schell, Co-Chairman of the Ad Hoc Inter-Professional Study Group on Corporate Conduct<sup>62</sup>, believed "the criminal sanctions proposed will not provide the strong medicine needed" (United States 1977g, p.140). Von Mehren also argued along the same line of reasoning regarding the approach that was taken in this bill. From his point of view, this approach required proof of "the corrupt nature of the payment ... to prove a state of mind" (United States 1977g, p.152). The language of the bill was perceived to be following "the conventional bribery language" which required determining subjective intent or a corrupt motive (United States 1977g, p.153).

The disclosure approach, on the contrary, would require corporations only to prove the facts and "to report all payments made directly or indirectly to government officials [or] be subject[ed] to prosecution for failure to report" (United States 1977g, p.152). The other argument was that the crime defined "in a reporting and disclosure provision is a much simpler crime with fewer elements of proof" to be used by a U.S Attorney "to

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<sup>62</sup> The group was formed in 1977 "by the chief executive partners of the nine large independent accounting firms of the United States and ten active members of the Bar from Washington and New York" (United States 1977g, p.135). Schell and Kennedy both were the co-chairperson and Von Mehren was the chairperson of this committee.

frame an indictment and develop his case” (United States 1977g, p.152). Von Mehren urged the House to “give the most careful consideration as to whether the criminal provisions will really do the job that so desperately needs to be done” (United States 1977g, p.149). The recommendation was to seek help and advice on this matter from the chairman of the corporations’ audit committees.

## **2. Passage of the FCPA**

The above bills, S. 305 and H.R. 3815, were both supported by the White House. This reflected a change in the White House attitude since the election of Jimmy Carter. The Administration had very little to do with the actual passage of the Act and were only representing Proxmire’s network. This was partly due to the hearings being conducted by the Congress and the SEC, and President Carter and his cabinet being affected by the actors of Proxmire’s network (Rocco 1999). Carter and his administration were “guided by a high moral obligation” (Caron & Electric 1981, p.21). The Vietnam War and Watergate Scandal had led to moral outrage and an urgent moral reform in the U.S. (Cragg & Woof 2002). Ford, former President, was only in favour of the bills his task force had introduced to the Congress, which were never debated in the Congress. The Carter presidency had ended this division and led the Congress to move towards passage of a law by the end of 1977.

By September, H.R. 3815 was passed by the House Committee on Interstate and Foreign Commerce (U.S. House of Representatives 1977b) However, due to the bill’s shortcomings, and the power that actors’ of Proxmire’s network had in mobilising and

enrolling their allies, it was “never considered on the floor of the House” (Greanias & Windsor 1982, p.63). The shortcoming of the bill was that it solely took a criminalisation approach and lacked the accounting requirement. In relation to S.305, while the debates were dominated by the anti-bribery and title II provisions, little attention was given to the accounting provisions (Greanias & Windsor 1982). By May 1977 the Senate passed S.305, and the House passed this bill in lieu of the H.R. 3815 in November (Greanias & Windsor 1982).

By December 1977, S. 305 was referred to a conference committee. The committee’s main recommendations were to incorporate the Senate title of the bill, the Senate Section A and B of the accounting provisions and the House bill’s penalty provision (U.S. House of Representatives 1977a). The conference committee amended the accounting provisions to include the wording “in reasonable detail” as part of section A of the bill, integrity of accounting records and reports (U.S. House of Representatives 1977a). The emphasis on terms “in reasonable detail” and “reasonable assurance” were to distinguish the Act requirements from the materiality concept and demonstrate that “[t]he statute does not require perfection” (Securities and Exchange Commission 1979a, p.1151). Also, it deleted the wording “adequate” as per the AICPA reasoning, as explained in chapter five.

Bill S. 305 was approved by the Senate “without debate after minor amendments” (Rocco 1999, p.167). The accounting provisions had only “focused on enhancing the accuracy of corporate accounting procedures and the reliability of the audit process” and adopting “neither the criminalization nor the disclosure approach” (Rocco 1999, p.167).

Hence, the FCPA was passed by the Congress “with unusual speed and surprising unanimity” (Lacey and George 1997-1998, p.132), despite Senator Church’s assertion during 1976 on the Senate floor regarding the bill not being an appropriate remedy since lobbyists of companies were not opposing it (Siedel 1981). This explained the ability of Proxmire’s new network in effecting and enrolling the outside actors and persuading them in approval of their solution.

The Act was described as “in many ways the most important act affecting accounting since the Securities Act of 1933 and 1934” (Auerbach 1978 cited in Bathen 1978, p.1261). Williams in one of his speeches, as spokesperson of the Proxmire’s network, described the Act as the “major auditing development of recent years” (1981, p.1). The Act was initially known as the “Lockheed Law” due to involvement of corporations such as Lockheed in the investigations and hearings, as was explained in chapters two and four (Biegelman & Biegelman 2010, p.4). The claimed purpose of the FCPA was to protect investors as well as to regulate the accuracy of financial information of the companies.

## 2.1 Sections of the Foreign Corrupt Practices Act

The Act consisted of four sections: Section 101 containing the title of the Act, section 102 covering accounting standards, and sections 103 and 104 dealing with foreign corrupt practices. The accounting provisions were passed as a series of amendments to the Securities Exchange Act of 1934 which increased “the degree of federal involvement in the internal management of public corporations” (Lacey and George

1997-1998, p.133). These provisions of the act “incorporated only [the first] two of the four rules proposed originally by the SEC” (Dundas and George 1979-1980, p.518) which required registered and reporting issuers under the Securities and Exchange Act to:

- maintain books and records accurately reflecting the transactions and dispositions of assets of the issuer;
- maintain an adequate system of internal accounting controls designed to provide reasonable assurance that specified objectives are satisfied (Securities and Exchange Commission 1977, p.1).

The above sections were explained by Williams, SEC chairman, as being “consistent with, and supportive of, precepts of good management” (1980, p.41). From the commentators’ viewpoint also the above sections were demanding “a tighter degree of management control of corporate expenditures and were designed to make it easier for the SEC to detect when a firm failed to disclose the required information” (Sheffett & Calantone 1993, p.368).

The FCPA placed new and significant obligations on issuers to make and keep accurate records and to maintain a system of internal accounting controls (Deming 2010), as perceived to be strengthening controls which would putatively enhance corporate accountability and ultimately public confidence in the corporate sector (cited in Williams 1979b). These sections were viewed by the Congress “as a measure to foster managerial accountability and corporate integrity by eliminating the weaknesses in corporate financial control and recordkeeping which permitted corrupt payments” (Goelzer 1979, p.4). As stated by Cragg and Woof (2002, p.123), this view was not shared by American corporations who could not “afford to treat their overseas

operations as a minor theatre of operations where experiments in morality could be conducted” as overseas operations’ profits were huge “at a time when domestic profits at home were under siege”.

Despite all of the criticism, the provisions were a self-regulatory measure to allow the companies “in conjunction with its outside accountants and counsel” to self-discipline their affairs without Government involvement as the primary administrator (Williams 1979b, p.3). Williams (1981, p.1) believed the criticisms were partly related to the perception that the accounting provisions “were considered truisms” and that the FCPA “was passed without congressional dissent”. He argued these arguments were raised as the accounting provisions were viewed “from an abstract perspective” which merely seemed to “codify a basic and uncontroversial management principle” (Williams 1981, p.1).

## 2.2 The FCPA’S Accounting Provisions

### 2.2.1 Maintenance of Accurate Records

Subsection A of the accounting provisions (section 102) of the FCPA required “Every issuer ... shall ... 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” (emphasis added The Foreign Corrupt Practices Act 1977, p.214). This requirement was later included in the SOX Act section 404 as well (Biegelman & Biegelman 2010). Members of the AICPA were concerned, as argued in chapter five, about the generality of the provision and the use of the word “accurately and fairly” as it



relates to being exact. It was maintained this was not achievable by companies as “there is no standard against which achievement of that precision can be measured” (United States 1977d, p.161). The issue was not addressed by the Congress or the SEC in rewording the provision based on the AICPA’s proposed amendments to H.R. 15481 and S. 305 which was to change the wording to ‘appropriately’.

### 2.2.2 Maintenance of a System of Internal Accounting Controls

Subsection B of the accounting standard provisions of the act obliged companies to employ a system of internal control by stating that

Every issuer ... shall ... devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that

(i) transactions are executed in accordance with management's general or specific authorization;

(ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets;

(iii) access to assets is permitted only in accordance with management's general or specific authorization; and

(iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences (The Foreign Corrupt Practices Act 1977).

This subsection of the accounting provisions, represented “the most significant intrusion of Government into corporate affairs since the original enactment of securities legislation in the 1930’s” (Siedel 1981, p.444). In corporate history “[i]t was the first time the federal government imposed standards of corporate governance upon public companies” (Giudice 2011, p.351) as there was “a profound and pressing need to seek ways to raise the levels of conduct of corporate management” (Lacey & George 1997-1998, p.129). This requirement of the federal law was established long before the SOX act “was ever envisioned” which required “strict internal controls within publicly traded U.S. companies to prevent fraud” (Biegelman & Biegelman 2010, p.4). However, due to political influences and lack of government agencies’ power to enforce the FCPA, as explained in this chapter and the following chapters, it was reintroduced in more detail in the SOX act.

This subsection as well as not detailing a clear meaning for a good internal control system, did not require the external auditors to “attest to whether an enterprise was in compliance with the FCPA’s internal control reporting requirements” (Moeller 2014, p.9). The AICPA addressed these issues by forming an independent commission in November 1974, called the Commission on Auditors’ Responsibilities. As the chairman of the commission was Manuel Cohen<sup>63</sup>, it was known as the Cohen Commission. The Cohen commission was “only an advisory group without authority to implement” their

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<sup>63</sup> He was a member of the staff of the SEC from 1942 to 1961 and after was appointed as a commissioner. From 1964 to 1969, Cohen was appointed as the SEC’s chairman.

recommendations, with the purpose of improving the future of the auditing environment and the nature of the services they offered in society (Cohen 1977, p.3; The Commission on Auditors' Responsibilities 1978).

#### *2.2.2.1 Cohen Commission Recommendations*

The Cohen commission recommendations and conclusions were released after three years in a report titled 'Report of Tentative Conclusions' (Cohen 1977; Moeller 2014). The report was released "about the same time as the release of the FCPA ... [and] ran into a torrent of criticism" (Moeller 2014, p.9). The criticisms, mainly provided by external auditors, were related to the report's recommendations about lack of precision in definitions and the role of external auditors in assessing internal control systems. For example, one of the recommendations was based on the premise of "[t]he study and evaluation of internal control is an important aspect of an audit" in "the prevention and detection of fraud" (The Commission on Auditors' Responsibilities 1978, p.39). The recommendation required auditors to allocate resources for assessing the condition of this control system, which was "not explicitly recognized in professional standards" (Cohen 1977; The Commission on Auditors' Responsibilities 1978, p.39). Addressing this shortcoming in audit standards was important because, "[a]ccounting information is ... controlled by an entity's internal control system" which is under the review and supervision of the management (The Commission on Auditors' Responsibilities 1978, p.7). As a result, the external auditors as "supported by empirical studies" were recommended to prepare a comprehensive report which was quite different from the then standard "one or two paragraph report" that served "merely as a symbol" and was "rarely read" (Cohen 1977, p.6).

The Cohen commission's report also included recommendations in relation to clarifying the responsibility of independent auditors for detection of fraud, because "the nature and extent of that responsibility have been unclear" (The Commission on Auditors' Responsibilities 1978, p.31). This was explained to be a major and important aspect of the independent auditor's function that had caused difficulties partly due to their inability "to assume greater responsibility in this area" (The Commission on Auditors' Responsibilities 1978, p.31). Auditor's responsibilities were suggested to include "reasonable assurance that the financial statements are not affected by material fraud and also to provide reasonable assurance on the accountability of management for material amounts of corporate assets" (The Commission on Auditors' Responsibilities 1978, p.36).

The AICPA had included several of the recommendations in relation "to the substance of the standard of care for fraud detection" on their agenda (The Commission on Auditors' Responsibilities 1978, p.37). Also during the same time period, the Auditing Standards Board of the AICPA was in the process of issuing an auditing standard requiring auditors to search for management fraud. The two exposure drafts issued by the AICPA were, Statement on Auditing Standard (SAS) 17, 'Illegal Acts by Clients' and SAS 16, 'The Independent Auditor's Responsibility for the Detection of Errors or Irregularities'. SAS 16 provided

guidance on the independent auditor's responsibility for detecting [material] errors or irregularities ... such as deliberate misrepresentations by management ... or omission of the effects of events or transactions; manipulation, falsification, or alteration of records or documents

while examining financial reports and evaluating internal accounting controls (The Auditing Standards Executive Committee 1977b, p.1-2).

Another recommendation of this report was related to managements' and external auditors' failure in recognising and exercising a "crucial element of judgement required by generally accepted accounting principles" (The Commission on Auditors' Responsibilities 1978, p.17). The Cohen Commission recommended a report by management to acknowledge their responsibilities for the financial statement and assessment of the internal control system. External auditors were advised to make "an evaluation of the cumulative effect of management's judgement in the presentation of financial statements", since financial statements as a whole might be "biased or misleading" (The Commission on Auditors' Responsibilities 1978, p.17). Based on its report, some of the recommendations were adopted by the AICPA and the SEC (The Commission on Auditors' Responsibilities 1978). Also, the recommendations re-emerged during the congressional hearings in relation to the SOX act as briefly pointed out in other chapters.

#### *2.2.2.2 FCPA Subsection B Language*

As mentioned in chapter five, the language of subsection B was very similar to the AICPA auditing standard which raised concern that the "language that may provide guidance to accountants and auditors may not be sufficiently precise to define conduct that could result in civil or criminal sanctions" (AICPA cited in Bathen 1978, p.1262). On this point it was argued by Dundas and George (1979-1980, p.877) that "[t]he

language of subsection (B) closely reflects the accounting profession's own objective", since this standard was

originally developed ... to assist independent auditors in evaluating a firm's internal accounting controls to determine whether errors that could materially affect the reliability of the firm's financial statements could be prevented (Bathen 1978, p.1262).

The AICPA had feared that the adoption of this subsection would lead to auditors facing serious problems (United States 1977d). Partly because the role of the independent auditor did not extend to evaluating the adequacy of internal control systems "for the purpose of compliance by the issuer with legal standards, but rather ... to form judgements relative to the scope of the audit" (United States 1977d, p.210). Some commentators accordingly, regarded the act's accounting provisions, particularly the internal control standards, as excessively vague (Securities and Exchange Commission 1981; Siedel 1981) and lacking in clarity (Roberts 1989).

The AICPA concern with the language used to explain the requirement of the internal control system was not reflected in the act. As explained in chapter five, their argument was, most of the companies "had very good systems" and there was no indication of "lack of adequate systems of internal accounting controls" but "circumvention of internal accounting controls" (United States 1977d, p.158). The language they were proposing was to amend the act by making unlawful "avoiding or circumventing ... internal accounting controls" (United States 1977d, p.165). The AICPA also had argued companies seeking guidance on the compliance requirements for an *adequate* internal control system may turn to the legal profession for advice and that they might consider a "checklist-type approach" (United States 1977d, p.163). In this regard, companies may

attempt “to attain a system that meets a minimal legal standard rather than to attain the best system suitable to the circumstances” (United States 1977d, p.163).

However, the SEC endorsed the language as being acceptably clear for businesses to follow by arguing that these objectives provided “a reasonable basis for the implementation of the required system of controls, and that such objectives are already familiar to the business community” (The Committee on Corporate Law and Accounting 1978, p.337). Williams, SEC chairman, stated the term reasonable assurance was mainly “a cost-benefit criterion” that management were familiar with in implementing internal control systems within their organisation (1980, p.43). This would ultimately lead to management systematically reviewing the internal control procedures and accuracy of the corporate records to “enhance public confidence in the corporate sector” (Williams 1980, p.46).

### 2.3 Guidelines Supplementing the FCPA Provisions

“The SEC and DoJ consistently refused to issue guidelines concerning the application of this Act” (Gustman 1979, p.382). Siedel (1981, p.459) argued “[t]hroughout the legislative history, there was little attempt to define the specific words and phrases used in the internal control provisions”. The reason being, the SEC and the DoJ, both believed “the ambiguities of the Act were desirable for deterrence and that clarifications would provide incentives [for managers] to circumvent the Act’s prohibitions” and find its loopholes (Lochner 1980; Longobardi 1987, p.462). As previously explicitly demonstrated, this was partly due to Proxmire wanting to have the SEC acting as the

spokesperson of his network as well as keeping his network flourishing. For this reason, the accounting provisions were sponsored by Senator Proxmire and his network twice during late 1976 and early 1977 and were unanimously passed in May 1977 and were unchallenged in congressional debates and hearings (Bialkin & Atkeson 1979; Siedel 1981). Bialkin, chairman of the Federal Regulation of Securities Committee, in a program presented by the Committee on Federal Regulation of Securities of the Section of Corporation, Banking and Business Law stated the same argument that “the force behind the legislation was too much to overcome and the bill went through ... [with] very little legislative history” (1979, p.626).

As addressed by Harold Williams, the then chairman of the SEC, during a conference in 1981,

Indeed, it is the lack of more specific guidelines which, since the act became law, seems to have generated the greatest concern. Some commentators regard the act's accounting provisions as excessively vague (Securities and Exchange Commission 1981, p.10)

and lacking in clarity (Roberts 1989). This is because the FCPA adopted the generalised objectives from the statement of Auditing Standard (SAS) number one (Gary 1990) regarding the definition of accounting controls as well as the SEC’s reluctance to issue guidelines, as will be demonstrated in this chapter and the following.

The SEC refused to issue interpretive rulings, announcing in 1978 that

[a]s a matter of policy and in light of the legislative and administrative history of the act, the Commission does not intend to render interpretive advice on the applicability of the act's proscriptions to particular factual situations (Securities and Exchange Commission 1978, p.183).

It could be argued this was partly due to the SEC chairman’s confidence in the accounting profession. As he stated



major efforts ... [had] been made by the AICPA and by the accounting firms to develop materials and provide guidance to assist managers and directors in establishing, evaluating, and monitoring internal accounting control systems (Williams 1981, p.20).

The Department of Justice guidelines did not also pertain to the accounting provisions of the act and application of these requirements which “lacked specificity to serve as an effective standard for enforcement purposes” (Gary 1990, p.13). Although the concept of audit committees were inherent in the FCPA (Goelzer 1979), it was not fully applied and was only “achieved after another era of corporate scandals ...that resulted in the enactment of the Sarbanes Oxley Act of 2002” (Black 2012, p.1101)

The SEC delegated “the task of developing compliance guidelines to the accounting profession” (Miller 1979, p.295). The AICPA had prepared reports addressing managements’ responsibilities in relation to internal control and issued two auditing standards, as previously mentioned. SAS 17 as one of the standards issued in 1977, provided guidance for auditors when discovering material illegal political contributions and bribes during their financial statement examination (The Auditing Standards Executive Committee 1977a). The standard required auditors to be “aware of the possibility that illegal acts may have occurred that may have a material effect on the financial statements” and if needed to “perform additional procedures to investigate such matters” (The Auditing Standards Executive Committee 1977a, p.2). Another standard, SAS 20, was about the auditors’ duties in relation to weaknesses in internal control systems. It was called “required communication of material weaknesses in internal accounting control” requiring

the auditor [to] communicate to senior management and the board of directors or its audit committee material weaknesses in internal accounting control that come to his attention during an examination of financial statements made in

accordance with generally accepted auditing standards (Auditing Standards Executive Committee 1977).

### 3. Initial Enforcement of the FCPA

In relation to maintenance of accounting information and internal accounting controls, the Congress did not provide any separate criminal or civil penalties (Dundas and George 1979-1980). The SEC was given the civil authority to investigate the violation of criminal prohibitions and to cooperate with the DoJ to ensure “the evidence needed for a criminal prosecution does not become stale” (Black 2012; United States 1977c). The Senate in their final report in 1977 (1977, p.7), explained the investigative responsibility was not feasible to be solely given to the Department of Justice, as it was duplicating “the investigative capability” that the SEC already had. It would also have increased the cost to enforce the act to the Government. This was however, “despite the SEC’s statements that the provision did not fit within its mission” (Black 2012, p.1094) and corporations’ concerns for potentially “being investigated and prosecuted twice for the same offense” (Sheffet & Calantone 1993, p.368). The Senate believed the

division of responsibility will result in a stronger enforcement effort compared to an exclusive assignment to the Justice Department. It is often difficult to assemble the degree of evidence required in a criminal action, but enough evidence may exist to enable the SEC to halt a continuation of the corrupt practices through an injunctive action. [Also], by assigning to the SEC enforcement responsibilities for the new prohibition, it will strengthen the Commission's ability to enforce compliance with the existing requirements of the securities laws, and with the new accounting provisions recommended by the Commission and included as section 102 of the bill (United States 1977c, p.7).

As demonstrated previously, this delegation of authority to the SEC was derived mainly from the commission’s early concern and leadership on the questionable payment issue via their voluntary program when the other government agencies were asleep (United

States 1977b). The program had demonstrated the SEC's apparent expertise in investigating these cases and their political independence from other governmental agencies and the executive branch (United States 1977b; United States 1977c).

### 3.1 A Hollow Victory

As explained in this and previous chapters, Proxmire's network was successful in enacting the legislation. However, they failed in effecting the enforcement of the act. It can be said that the network had only achieved a minor achievement, since the goal of the network was only partly achieved and did not have the expected effect on corporations changing their behaviour towards illicit payments. Lack of enforcement can be translated to the ultimate defeat of the network and probably the dissidence of its actors. Proxmire's network disintegrated and he was not able to re-create a network with the goal of governing and overseeing the SEC and the DoJ, which were responsible for enforcing the FCPA.

Posadas (2000, p.358) argued that doubts remained about success of the act in the areas of compliance and enforcement. The number of prosecutions were initially few and the "enforcement was inconsistent" (Biegelman & Biegelman 2010, p.15). According to Rossbacher and Young, many of the cases "were uncovered not by the SEC or Department [of Justice] but almost adventitiously by the press" (1997, p.134). The press was more successful in revealing cases related to corruption and bribery than the independent auditors, the SEC or the DoJ, representing that the system was not working as the SEC had claimed in their arguments in the 1970s, that was explained in previous chapters. Concerns with lack of enforcement, were initially raised by Hills when the

SEC proposal, S.3418, was introduced to the Senate with the hope of providing a better basis for prosecutions by saying

I share ... [the] concern that the white collar crimes in this country are not being prosecuted with sufficient vigor, and that the sense of justice in the country suffers when people who engage in some of these practices are not incarcerated as readily as are people who engage in other kinds of crime (United States 1976l, p.28).

The number of cases pursued under the FCPA until 1997, by the SEC was only three and the DoJ only brought forward thirty cases. The enforcement of the act was increased about 2002, in the wake of scandals such as Enron which had awakened a movement for new corporate reform, as explained throughout this study (Borgman & Datar 2012; Searcey 2009). According to Weismann the level of enforcement of the act in 2005 was still

less than reasonable. Of six new cases filed...three were resolved by informal corporate non-prosecution agreements; ... [the] two cases ultimately resulted in the imposition of criminal fines and penalties (2009, p.619).

This argument was also discussed by Koehler (2010, p.907) saying that enforcement of a significant majority of the FCPA cases prior to 2010 were “a façade ... resolved without FCPA anti-bribery charges”.

No matter what the SEC and the DoJ attempted to enforce the end result would be the same which was “privately negotiated and subjected to little or no judicial scrutiny” (Koehler 2010, p.924). As such, where the FCPA was enforced by the SEC and the DoJ, consequences were “minimal, typically resulting in a fine less than the value of the economic transaction giving rise to the disposition combined with a non-prosecution agreement” (Weismann 2009, p.623). This was partly due to the SEC concluding the

cases with some form of settlement at the time they were filed (Securities and Exchange Commission 2010) leading to cases not going to trial and the SEC consenting to court-approved settlements (Bagby 1983).

The lack of prosecutions, meant the theory behind the accounting provision of the act “had never received a court test” which would have helped in bringing “different considerations into play” for the two bodies in charge (Adler 1982; Sporkin 1997, p.274). Courts did not have the “opportunity to define most of the key factors” in clarifying ambiguities and “rectify[ing] some of the grey areas in the Act” (Adler 1982; Pines 1994, p.196). The other issue was the lack of cooperation between the SEC and the DoJ, since the accounting and antibribery provisions tend to overlap in many cases. Pines (1994, p.193) demonstrates the “cozy interplay between the agencies”, the SEC and the DoJ, had never occurred and joint efforts by them to investigate and prosecute were “virtually non-existent”.

### *3.1.1 A Case of the FCPA Enforcement Failure*

The above arguments represent the failure of Proxmire in completely implementing his network solution to the problem of domestic and foreign bribery and illegal payments. The political and legal environment that surrounded the enforcement of the act, led to low levels of prosecutions. The Westinghouse Corporation’s<sup>64</sup> “construction of a nuclear reactor facility in the Philippines” story, is an example of a case that was under investigation from 1971 to 1991 and managed to side-step FCPA prosecution despite strong evidence that was presented in the court (Cragg & Woof 2002, p.199). This case

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<sup>64</sup> Westinghouse Corporation and General Electric at the time, were dominating the U.S. nuclear industry domestically and internationally.

was described as the most infamous instance of kickback payments made by Westinghouse Corporation to political players to obtain a contract, even though the SEC and the DoJ cleared the company of any impropriety (Boyce 1993; Butterfield 1986). The nuclear reactor had become “a major political issue in the Philippines” during its construction (Butterfield 1986, p.2).

From the mid 1960s, foreign borrowings played a key role in the Philippine’s development and economic growth and supposed “improving the well-being of present and future generations of Filipinos” (Boyce 1993, p.245). The Government was substantially involved in agriculture and industry development. The World Bank was also requiring “export-oriented growth” from the Philippines in return for its support of their industrial projects the regime undertaken (Cragg & Woof 2002, p.200), even though these foreign borrowings “financed too little genuinely productive investment” in the country (Boyce 1993, p.348).

The country’s growth needed a reliable electric power supply, which was only possible through a nuclear power plant. In 1973, proposals were submitted for the construction of the nuclear power plant by the Westinghouse Corporation and General Electric (GE). Westinghouse Corporation’s proposal was awarded the contract, as it was advised by a political authority<sup>65</sup> to “hire a lobbyist close” to the Philippine’s President, Ferdinand Marcos, and pay him a commission, to win over GE (Butterfield 1986; Seagrave 1988, p.290). Their proposal was discussed privately and was accepted, even though based on

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<sup>65</sup> Westinghouse had hired Disini who was “married to the first cousin of Imelda Marcos [Ferdinand wife] and became a close friend and golfing partner of the president” (Beaver 1994, p.272).

the Philippine national power agency, the GE's proposal costing was lower, detailed, and favourable (Beaver 1994; Cragg & Woof 2002; Seagrave 1988).

The quoted prices by Westinghouse after the initial acceptance of the proposal, were growing and were, by far, more than similar nuclear plants constructed in other parts of the world such as South Korea and Taiwan. It was described by one of the then officials as a contract for one reactor but with the price for two reactors and half of the expected power output (Boyce 1993; Butterfield 1986; Seagrave 1988). The nuclear plant costing "was roughly double that of a comparable reactor being built in South Korea" and it was still financed by the Export-Import Bank since according to the chairman of the bank "the two big boys have agreed to it" (Boyce 1993, p.321).

As described by Butterfield (1986, p.2) "the largest source of money came from a Swiss subsidiary of Westinghouse that funneled fees for Mr Disini into European banks". The Swiss subsidiary was solely established to handle the nuclear plant contract. The cost of construction was questioned by the U.S. embassy in the Philippines. The U.S. embassy in their report to Washington, raised concerns in relation to the price being "inflated [and] that there were reports of payoffs and that the project would never pay for itself" (Boyce 1993; Butterfield 1986, p.1). From the terms of the contract it was evident that "the price of the equipment being sold to the Philippines was inflated, as a way to cover the cost of the fees to Disini" (Butterfield 1986, p.1)

Due to the proneness of the Philippines to earthquake and volcanic activity, the plant site was important. However, the company had initiated the preparation of the site before the safety studies were completed by the two companies in charge<sup>66</sup>. Beaver (1994) stated the hasty move of Westinghouse in relation to location reflected Marcos push for the plant to be built as soon as possible. The construction itself began while the “technical reports on potential risks” and safety studies were not finalised (Cragg & Woof 2002, p.201). Westinghouse also had difficulties with obtaining an export licence for the plant components. The U.S. Nuclear Regulatory Commission (NRC) “had refused to issue the licence, which prompted Westinghouse to file a lawsuit against the commission” (Beaver 1994, p.275). The export licence was finally issued to the company to avoid any “embarrassment to the U.S. government”, while the safety of the plant was in question and in the process of being reviewed (Beaver 1994, p.275).

At the time of construction, the Three Mile Island nuclear power accident in the U.S. had happened and to show his concerns, Marcos had ordered an investigation of the safety measures of the plant and “ordered a halt to the plant’s construction” (Beaver 1994, p.275; Seagrave 1988). But the company responded that the plant was safe and after negotiations with the Government and the bodies in charge, the construction resumed. Beaver (1994, p.275) argued that if Marcos was “really serious about cancelling the project, the lack of a construction permit would have been an easy way” to break the contract.

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<sup>66</sup> The two companies namely, Ebasco services and National Power Corporation, were investigating the two possible sites for the nuclear power plant. Their investigation was assisted by the International Atomic Energy Agency and the Philippine Atomic Energy Commission (Beaver 1994).



The Westinghouse issues during 1978 were the centre of newspaper reports. The SEC and DoJ initiated a joint investigation based on the newly established legislation, the FCPA, and “concluded that there was no evidence of irregularities in Westinghouse’s relationship with the Philippine government” (Cragg & Woof 2002, p.201), despite the SEC findings that “a district manager for Westinghouse in the Philippines destroyed six volumes of documents related to the project, then retired” (Seagrave 1988, p.291). The bribery payments, as will be explained, were again questioned but the company was successful in sidestepping the FCPA prosecution. Based on Butterfield’s investigations,

the banker calculated, the commissions from the Westinghouse project had netted Mr. Disini and Mr. Marcos about \$80 million. This is close to an estimate by the Philippine National Computer Center in 1975 (1986, p.2).

In 1985, the construction was completed and was rushed as the election for presidency in the Philippines was close and it was “sensed that Marcos’ days in office were numbered” (Beaver 1994, p.276). Based on an investigation by International Atomic Energy Agency, the plant was unsafe as “Westinghouse had cut corners”, while the company had announced that they were proud of the plant (Beaver 1994, p.276). When the new Government came on board, it filed a lawsuit against the company because of the alleged bribery payments to the political players and the plant being unsafe. The case was initially heard by the International Chamber of Commerce in Switzerland and was ruled in favour of Westinghouse (Beaver 1994; Cragg & Woof 2002). This was because the supporting “evidence was not sufficient” and not directly related to the allegations (Beaver 1994, p.277).

Later on Westinghouse was denied its request for dismissal of the case in the federal court and it “opted for an out of court settlement” (Cragg & Woof 2002, p.202). However, the amount that Westinghouse agreed to pay the Philippines’ Government did not even cover “one year's interest payments on the debts the country incurred to build the plant” (Hawley et al. 2000, p.43).The nuclear plant had cost “more than \$2 billion” and had “never generated a kilowatt of electricity” (Boyce 1993, p.348). In 1999, the Philippines Government “decided to dismantle all the nuclear components of the plant” and turned the site into a science park (Cragg & Woof 2002, p.202).

#### **4. Conclusion**

By 1977, the Proxmire network was the only successful network in representing and obtaining the approval of their bill by the Senate. S. 305 was the preferred bill by the Carter administration. The administration did not want to delay the passage of the legislation. The accounting provisions of S. 305 were not widely discussed or modified during the 1977 congressional hearings, as it was already approved by the Senate. As noted, the accounting profession, the AICPA, had previously criticised the language of the provision and it was not implemented by the Congress or the SEC. The accounting provision was argued by the then SEC chairman to be clear for corporations to implement and be utilised. It was a self-regulatory measure for corporations to self-discipline their affairs without Government intervention.

The enforcement of the FCPA from inception, was minimal and the end result for most cases were private negotiations with minimal judicial scrutiny. From the early 2000s the FCPA enforcements increased due to “corporate scandals ... and the resulting corporate

reform efforts” (Biegelman & Biegelman 2010, p.45). The renewed “attention to the FCPA and anti-corruption compliance” (Biegelman & Biegelman 2010, p.36) stemmed from the passage of the SOX act, as corporations had “uncovered more illegal payments as part of the SOX related financial reviews” (Biegelman & Biegelman 2010, p.45). The act’s emphasis was on strengthening “corporate accountability and governance of public companies” by focusing on “the importance of compliance and ethics” (Biegelman & Biegelman 2010, p.36).

After the passage of the FCPA, no guidelines were issued by the SEC and DoJ. As clarification of the act would have led to corporations circumventing the accounting provisions of the act. The task of clarifying the legislation was left to the accounting profession, which was not passionately executed by them. However, due to simplified and perceived vague language of the provisions, the act was described to be costing corporations and being a roadblock for their foreign affairs and operations. As will be explained in the following chapter, by the change of administration and political agenda in the White House, the FCPA was viewed as one of the most unproductive federal regulations, because the act had increased the regulatory burden on business and had diminished their competitiveness in their international dealings. This argument was utilised by the Government to amend and even eliminate the act.

# Chapter Seven:

## Amendments Made to the FCPA

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*In the late 1990s, the SEC had become convinced that auditor commitment to independence had slipped. ... The issue of auditors providing consulting services to audit clients was not new. ... The Metcalf, Moss and Dingell Congressional committees had expressed similar fears in the 1970s and 1980s (Fritz 2012).*

During 1977, the accounting provisions “were never debated in the House of Representatives. In the Senate...very little consideration was given to the accounting standards” (Dundas and George 1979-1980, p.870). As a result the language of the accounting section was simplistic and vague (Baker & Bettner 1997) and was argued to have caused corporations “to incur unnecessary costs” (United States 1981, p.111). The vagueness of the accounting section had been questioned since it was introduced as part of S.3418, as discussed in previous chapters. The lack of clarity was partly related to the law being a matter “of moral judgements” (Greanias & Windsor 1982, p.138).

Senator Proxmire was one of the actors who had questioned the SEC’s recommendations and for this reason was forced to re-establish his network to accomplish his main goal of eliminating illicit payments. He argued that the corporations would not like the vagueness and stated “I think they would want the certainty. ... to know what they have to report and what they don’t have to report”

(United States et al. 1976, p. 13). The accounting profession, the AICPA, as outsider actors to the Proxmire network, also made suggestions to clarify the provision. However, after minor changes, the bill was passed by the House of Representatives and signed off in 1977.

The then U.S. trade representative, Senator Brock, in an article in the Washington Post claimed that the accounting provision shortcomings were due to the SEC, demand for “greater authority to regulate accounting and bookkeeping practices” which, “in the spirit of true Washington compromise, a law was produced that combined the worst of both worlds” (Brock 1981; United States 1981, p.82). This was due to the fact that the draft of the law was not challenged by “members of Congress, the administration and the business community ... for fear of being accused of favouring bribery” (United States 1981, p.82).

## **1. Review of the FCPA After One Year**

As stated by Soresen, a lawyer<sup>67</sup>, “[t]he ink was hardly dry before a steady drumbeat of attack on the statute began” by 1977 (United States 1981, p.414). As early as 1978, a White House task force and a new network comprising five working parties was established to undertake a study about ‘export disincentives’. This was due to the U.S. exports being “a high priority” of the administration and that international trades had become substantially “more important to the United States than in earlier years. And a

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<sup>67</sup> A partner in the law firm of Paul, Weiss, Rifkind, Wharton and Garrison

strong export position ... [had] become a matter of great significance to the economic strength and welfare” of the nation (United States 1980a, p.1)

The disincentives were enrolled as non-human actors to mobilise the network and enrol other actors such as the corporations. The disincentives were defined as “U.S. laws, regulations, and policies which attempt[ed] to use exports as a lever to obtain policy objectives or which ... [had] a secondary effect of limiting exports” (United States 1979, p.4). The FCPA was one of the important areas and “one of the most significant export disincentives” identified by businessmen and attorneys (United States 1980a; United States 1981, p.7) that were under review in determining its effectiveness based on “a cost-benefit analysis” (United States 1979, p.5). The review process took into account the cost of the legislation for the U.S corporations and the economy. The accounting provisions of the act were argued to also have “significant costs on exports and ... [corporations’] international competitiveness”(United States 1980a, chapter 9, p.7).

Members of these working parties included agencies from the executive branch which indicated their interest in this study. The Department of Justice, for instance, was an actor of this network and involved in the task force study. But the SEC was not included because as part of the review process the task force had mandated “to take enforcement responsibilities [of the FCPA] away from the SEC” (United States 1979, p.12). A working party of five was in charge of making recommendations based on the review and reports prepared by the other four working parties. Part of their initial and unapproved recommendations in relation to the FCPA was issuance of written

guidelines by September 1979 for the business community and preparation of periodical reports about “the level of export loss by U.S. companies because of this law” (United States 1979, p.16).

The news reports, such as the Times-News and Wall Street Journal, had announced that the task force was going to submit a recommendation, after an agreement was reached between different agencies involved in this review, to President Carter. Carter, who was initially an actor of Proxmire’s network and had signed the bill into law, called “for immediate weakening and eventual atonement of key provisions in the law that prohibits payment of bribes overseas by American corporations” (United States 1979, p.1). This was due to the fact that the act was described as being a roadblock for U.S. corporations which were exporting their products overseas. It was also creating anxiety among corporations’ employees of “utmost good faith” as to the implementation of the act (Securities and Exchange Commission 1981b, p.1467).

Eckhardt, during a hearing held in relation to this matter, stated that while there was considerable support for passage of this legislation, “there was a strong sub rosa effort to scuttle the bill. People unwilling to oppose the bill tried to insure that it never be brought up in the House of Representatives” (United States 1979, p.2). Even though the Congress based on article I of the constitution had the right to make the law, the president on the other hand had the right to “faithfully execute those laws” (United States 1979, p.2). This was the main concern from Eckhardt’s view point which related to undermining the enforcement of the FCPA rather than trying to remove the

ambiguities of the act, since it was perceived that the enforcement of the act was costing corporations in their foreign trade.

Renner<sup>68</sup>, chairman of the task force, assured the chairman and members of the Committee on Interstate and Foreign Commerce, in the hearing that the act would not be scrapped as “many portions of the act ... still would be applicable” (United States 1979, p.12). Eckhardt argued that Congress had spent considerable time and effort regarding the issues that the task force were concerned with before the act was enacted. The witnesses, for example former Secretary of the Treasury, who had testified in the Congress stated that paying bribes was not necessary “to have a successful export sales program” as such payments were sometimes made to outcompete U.S. corporations (United States 1979, p.19). He later on concluded that as a chairman of a congressional subcommittee he

is pretty tired of seeing a situation in which we hold open hearings, invite testimony ... and attempt to get the facts, and then are confronted with a subterranean attack on this bill itself, frequently by those who do not understand it and those who are not willing to expose their viewpoints to light (United States 1979, p.21).

## **2. Ronald Reagan and His Administration’s Agenda**

In 1980 Carter was defeated by Ronald Reagan “in a landslide electoral victory with his legendary promise” of getting the Government off the back of Americans (Gutterman 2013, p.11). Reagan and his administration advocated elimination of “ill conceived or unproductive federal regulations affecting business[es]” (Renk 1980, p.1) using a cost-

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<sup>68</sup> He was the counselor and special envoy, office of the special representative for trade negotiations, executive office of President Carter.



benefit analysis technique. Reagan as the newly elected President was replacing Carter and his administration in the network created to weaken and amend the FCPA. He, as a neoliberalist spokesman, was promoting “free market competition and deregulation as essential to the nation’s well being” as non-human actors (Barbara et al. 2010, p.776).

As argued by Cragg and Woof,

Privileging *realpolitik* over human rights and other ethical concerns meant that the Reagan administration was prepared to overlook the failure of its foreign allies to maintain a strict division between private and public interests (a *sine qua non* in the war against corruption), just as the Nixon administration had failed to maintain a clear distinction between its political interests and its responsibilities for public administration during the Watergate debacle (2002, p. 130).

Reagan indicated his alliance and friendship with the business community and had “been looking the other way” regarding corporate crime and opposing “anti-foreign bribery laws” (Williams 1985, p.3). He was interested in eliminating unproductive federal regulations from the point of view of corporations to publicise his concern for the increasing regulatory burden on the business community and their competitiveness towards international business. He and his administration indicated their dissatisfaction with the legislation as it was going to “cast a chill over the willingness of U.S. businessmen to push into foreign markets and thereby help boost U.S. export” (cited in Biegelman & Biegelman 2010, p.17). This argument was made contrary to the initial Congress consensus that was reached regarding corporations losing business was to be tolerated for the good health of the U.S. political and economic system.

During Reagan’s presidency the number of prosecutions under FCPA was low, but significant amendments were made to the act (Biegelman & Biegelman 2010). For

instance, between 1977 and 1988 the DoJ “initiated only twenty antibribery cases under the FCPA, and the SEC only three” and only a few of these cases went to trial resulting “in minimal penalties” (Pines 1994, p.192-193). The drop in the number of enforcements of the act was partly due to the Reagan administration reducing “funds of agencies handling corporate misbehaviour” which led to the SEC adopting “a hands off, free market approach” (Geo-Jala & Mangum 2000, p.246). Reduction in enforcement was also linked to the President of the time, for instance Reagan, appointing five of the SEC’s commissioners, which meant that “at least a majority of the commissioners ...tend to share the policy views of the current administration” (Mattli & Buthe 2005, p.415). Accordingly the SEC’s priorities and “approaches to regulatory matters ... [would] very much [be] a function of the mood of a period, reflected in specific political and economic realities” (Mattli & Buthe 2005, p.415). This was apparent during the Reagan presidency as the “SEC Commissioners and senior officials did not make major speeches addressing any aspect of the FCPA” (Black 2012, p.1105-1106). Also Shad, the SEC chairman in 1981 and during Reagan’s Presidency, in comparison to Williams had “focused on capital formation issues, and the Enforcement Division returned to core enforcement priorities and insider trading” (Black 2012, p.1105-1106). Lockheed was one of the corporations that had been indicted multiple times from the 1970s until 2009, yet during Reagan’s tenure no charges in accordance with the FCPA were pursued.

### **3. 1980’s FCPA Proposed Amendments**

The administration was in favour of repealing the accounting provisions of the FCPA completely, due to its unnecessary complexity, great cost and burden on U.S. corporations (United States 1981, p.177) without having “substantial benefit” for them

(United States 1983a, p.1). The U.S. corporations preferred the “loosening of both the FCPA’s accounting and anti-bribery provisions to a point effectively similar to repeal” (Guterman 2013, p.12). This is while the Subcommittee on Citizens and Shareholders Rights and Remedies was conducting “hearings on the problem of corporate accountability” and governance (Sommer 1980, p.57). The subcommittee was piecing legislation together called the Protection of Shareholders’ Rights Act of 1980 dealing with “governance of corporate boards” (Sommer 1980, p.57).

The AICPA president, Chenok, argued that “the business community was strengthening its recordkeeping procedures and internal controls” long before the FCPA was passed by the Congress (United States 1981, p.343). He further stated these costs were attributed as “classic start-up” and were “unavoidable and often associated with the implementation of a new law” (United States 1981, p.343) and were not without benefits. Accordingly, corporations in the future only faced incremental costs. Hills, the previous SEC chairman, also stated repealing of the accounting provision was “inadvisable since it has improved the corporations governance system in place” (United States 1981, p.367). Sommer too stated that because of the act, corporations’ managements had become more critical of the adequacy of their internal accounting system. However, Sommer’s statement can be claimed to be doubtful. As Treadway, SEC Commissioner, in one of his speeches, referred to three cases under SEC investigation during the early 1980s that had “cooked books” in a manner similar to the 1970s illicit payment cases (Treadway 1983). The investigations revealed

a failure of structure and governance ... [since] information about improper or illegal behaviour failed to reach top management, or the Board of Directors, or the Audit Committee for years before the crisis broke ... the Directors and senior management apparently failed to convey to others the need for accurate accounting, compliance with the securities laws, and the elimination of improper or questionable activities (Treadway 1983, p.6).

### 3.1 Enrolment of Actors in the Administration's Network

The DoJ welcomed the amendments and was enrolled in the network, as there were complaints regarding application of the act. The deputy attorney general of the Department of Justice, Schmultz, accordingly argued that the FCPA was enacted only four years ago and it is not a statute that would have been “on the books since the late 1700’s. It is not cast in stone” and changes are required for businesses to perform effectively (United States 1981, p.86). According to Bader and Shaw (1983, p.639) the purpose of the act was perceived differently as,

[o]riginally the FCPA was intended to force corporations to clean up their acts and to set a high standard of behaviour for American business.... Given the changes in the FCPA proposed ... one must question whether Congress is still committed to preventing such incidents. Ostensibly, the purpose of ... [these changes are] to clarify, not to weaken the FCPA.

Senator Brock, claimed the amendments to the FCPA were important as the act had undermined “export promotion” (United States 1981, p.41). He urged the Congress to eliminate “the export disincentive aspect of the Foreign Corrupt Practices Act” as it was “a priority of this Administration and the Office of the USTR<sup>69</sup>”. The Congress had the “responsibility to make the act work well” (United States 1981, p.277), while this viewpoint was not shared by all the public witnesses or Senators or Congressmen. Proxmire for instance, stated that since 1978 U.S. trade had dramatically improved despite the fact that the cost of doing business had increased as well.

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<sup>69</sup> The United States Trade Representative

### 3.2 1981-1982 Amendments of the FCPA

Between 1981 and 1986, around twelve bills in relation to amending the FCPA were presented to the Congress (Earle 1989; Longobardi 1987). The following sections detail some of the amendments introduced and extensively discussed in the Congress. During 1981 and 1982 a proposal was put forward to the 97<sup>th</sup> Congress to make a number of considerable changes in the FCPA (Bader & Shaw 1983) which would have changed the accounting provisions significantly and weakened the FCPA. The testimonies that were heard in relation to the proposals mirrored “what was heard after the enactment of the SOX legislation in 2002” (Biegelman & Biegelman 2010, p.17).

It is clear from the following sections that the corporations had “united and used money to promote neoliberal policies” (Barbara et al. 2010) as well as pushing for abolishment of the FCPA. Caron and Electric argued

many of those companies that were under investigation for corrupt practices have contributed CEO’s to economic committees appointed by President Reagan ... it is a signal to business to focus on profit, not accounting procedures (1981, p.21).

Reagan’s message was that corporations had “concentrated enough time and money” on cleaning up efforts and it was “time to get back to the business of getting business” (Caron & Electric 1981, p.21). Proxmire interpreted this message as the Republicans

profess[ing] to be the true supporters of the free enterprise system, yet when it comes time for the difficult reforms that will enable the free market system to truly work the way it should, the administration shrinks from embarrassing corporate cronies at home and corrupt allies abroad (Journal Washington Bureau 1976, p.2).

### 3.2.1 Senate Hearings on the Bills Presented

During 1981, several hearings were held in relation to Senator Chafee's proposal, S. 708, to amend the FCPA. The bill was the "first proposal to introduce a cost/benefit analysis" (Longobardi 1987, p.450) which, according to Brennan (1984), carried measurement difficulties. Senator Chafee can be argued to be representing the network that was initially established in 1978 by the administration (referred to as the administration network). Representatives from accountants, lawyers, academics and corporate executives, enrolled actors of the administration network, had testified at these hearings as the bill was in response to their numerous complaints (Brennan 1984). Another issue of concern from the Administration's viewpoint was that hearings were held towards the end of the fall session of the Congress and there were doubts in the ability of the Senate to approve the legislation proposal on time.

The proposed name of the legislation was "the Business Accounting and Foreign Trade Simplification Act" so that the "discussion could take place free from pro-bribery vs. anti-bribery rhetoric" (Koehler 2014, p.40). The legislation "was a political hot potato" (Koehler 2014, p.40; United States 1981, p.82) because of its name and the change in the title was also to avoid having businessmen "run away from undertaking business that might be misconstrued as being illegal" and not leaving "one with a chill" (United States 1981, p.81). The change of the bill's name was argued by Senator Wirth<sup>70</sup> as sending "the message that the United States Government was unconcerned about bribery- even to the extent that corruption would be called by another name" (Arieff 1983; Brennan 1984, p.67).

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<sup>70</sup> Timothy Wirth, a Democrat Senator from Colorado, was a member of the House of Representatives from 1975 to 1987 and a member of the Senate from 1987 to 1993.

The bill was the preferred solution, presented by the administration network. It was modifying the FCPA in a way to correct the impression that U.S. corporations are corrupt and “greater corruptor[s] of others” (United States 1981, p.75). The modification also was aimed to reduce “the unjustified competitive edge that foreign firms” had due to “the wide sweep and lack of clarity of the act” (United States 1981, p.75). This argument was not agreed upon by witnesses testifying, as Heymann<sup>71</sup> explained that the amendments would “create loopholes so wide that” would turn the FCPA “into a laughingstock or a nullity over time” (United States 1981, p.420).

The chairman of the subcommittee, D’Amato<sup>72</sup>, and the co-chairman Senator Heinz, as enrolled actors of the network, stated their agreement and support for the proposed solution and making changes to the provisions of the FCPA. D’Amato argued, on the one hand based on the SEC observation, “the accounting provisions of the act have provoked unprecedented anxiety among honest businessmen about the scope and meaning of the act, and about what it takes to comply” (United States 1981, p.1). During the hearings, this provision of the act was referred to as the “fancy accounting rules” that were not related to bribery and were “simply a response to an ill thought out accounting set of rules in the FCPA” (United States 1981, p.183). Sommer, the previous SEC commissioner, argued that if the SEC had “embarked upon a course of interpretation and guidance soon after” the passage of the FCPA, there would be no concern from business and the need to amend the act (United States 1981, p.370).

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<sup>71</sup> Former Assistant Attorney General in charge of the Criminal Division of the Justice Department. Graduated from Harvard law school.

<sup>72</sup> Chairman of the Subcommittee on Securities.

Senator Brock, who was in agreement with the changes, stated that the bookkeeping requirement was “overly broad” which was “unnecessary and excessive” (United States 1981, p.40). He further stated his opposition to “the continuation of the accounting and recordkeeping provisions of the FCPA” while supporting “the continuation of an effective anti-bribery law and further attempts to obtain an international anti-bribery agreement” (United States 1981, p.43). While the U.S Ambassador was seeking elimination of part of the accounting provisions, the Department of Commerce was urging “repeal of all accounting provisions contained in section 102” as it was “unnecessary to prevent illicit payments” (United States 1981, p.67). The Department of Commerce, General Counsel, Unger, asserted

[c]ompliance with... [the accounting] provisions is particularly difficult since their interpretation is unclear. This Administration is dedicated to eliminating unnecessary regulation of business. The removal of the accounting requirements is a *positive step* toward this goal (emphasis added) (United States 1981, p.71).

This statement confirmed the administration’s position as well as their preference for the criminalisation approach where the Department of Justice would be the only agency enforcing the law. This was viewed as a “matter of good Government” in placing the enforcement authority “in one agency” and eliminating the differences in interpretation and coordination of the law (United States 1981, p.80).

On the other hand, until then no other country had enacted similar legislation and would have reduced U.S. corporations’ competitiveness. Also, it was “naive to suggest that the United States ... [was] in a position to dictate unilaterally the code of conduct in world commerce” (United States 1981, p.2). The then U.S. Trade Representative claimed that



the absence of other nation's efforts in reducing the practice of bribery was due to the fact that the FCPA was ambiguous and confusing. So to resolve this problem, it was required to amend and pass a "workable, understandable and enforceable law" that would encourage international negotiations (United States 1981, p.60). Nevertheless, Chenok claimed the confusion followed partly due to the SEC's objectives becoming broader which "was not clearly seen by many observers of the legislative forum" (United States 1981, p.344). The SEC was moving away from its traditional purpose of "investor protection to management supervision" (United States 1981, p.345). As the aim of the accounting provision was to promote corporate accountability and "to codify good corporate management practice and thereby improve overall business accounting" (United States 1981, p.345).

Senator Proxmire, as the author of the original act and the principal actor of his network however was not in agreement with the proposed amendments and explained the changes as a backward step. Proxmire believed that the act had served its purpose by forcing corporations not to engage in contracts that they felt involved questionable payments to the agents or government officials. Its purpose was to make the corporations aware and concerned in this regard so that they would comply with the provisions of the act. But the main purpose of the FCPA, to prevent businesses engaging in bribery overseas, was overshadowed by their perceived losses in sales abroad and higher business costs. However, the losses in exports and sales were doubtful as corporations did not have the ability to "estimate with any precision the contracts lost to a competitor's bribe" (United States 1981, p.454). Also a study by

Professor Graham concluded that the act had “no negative effect on the export performance of American industry” (Graham 1984, p.107).

During the 1970s, Proxmire was able to successfully mobilise his network and persuade the actors to approve his solution being the preferred way forward. However, unlike the 1970s, he was the ranking minority member of the committee during 1981. He claimed the amendments were because of “an unprecedented lobbying effort by big business to gut the bribery law under the guise of alleged ambiguities which chill foreign trade” (United States 1981, p.380). This argument was agreed upon by Soresen, who as a new actor in Proxmire’s newly established network<sup>73</sup>, argued that business complaints about the ambiguities in the act were not the main issue and was due to the fact they could not openly “authorize or permit the payment of bribes abroad when so requested by local officials or when urged by their local agents” (United States 1981, p.399). He also mentioned that their dissatisfaction with the U.S. “imposing its ethical standards” abroad or lack of clarification was not regarding “seeking ... clarification of the act but vitiation, not guidance for those willing to stay clean, but loopholes for those willing to make payoffs” (United States 1981, p.400).

Proxmire was in favour of the SEC issuing relevant guidelines and regulations rather than amending the act. The proposed bills were weakening the accounting provisions which would reduced the number of civil or criminal actions taken. He described the amendments in modest terms, stating S. 708

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<sup>73</sup> As discussed in chapter six, Proxmire’s network was defeated because of the lack of enforcement of the FCPA.

beheads the Foreign Corrupt Practices Act and then puts the corpse of the Foreign Corrupt Practices Act to the torch and burns that corpse to a pile of ashes and scatters the ashes to the wind (United States 1981, p.5).

In his judgement the bill was allowing bribery to “flourish in overseas trade” (United States 1981, p.56). While, Senator D’Amato, in favour of the amendments, argued that the “pride of authorship” had stood “in the way of improving an existing statute” and changing it to an act that would “work better” (United States 1981, p.131).

Part of the perceived improvement in the legislation was observed by Soresen as granting permission to corporations to bribe “as a matter of practical commercial necessity” which meant that the legislation was going to be riddled “with loopholes ... encourag[ing] some American businessmen to bribe to the disadvantage of other American businessmen” (United States 1981, p.400), since S. 708 meant U.S. corporations would again be doing “business overseas by bribery. Companies ... once again wink[ing] at slush fund bookkeeping” (United States 1981, p.3). Proxmire called the bill a “probribery bill” as it gutted “the accounting sections of the act” requiring companies to “only keep books and records which reflect in all material respects its transactions” (United States 1981, p.4).

During the 1970s the books and records section of the act was criticised as it did not contain a materiality test. It was a similar story being repeated during the 1980s and the concept was enrolled by the administration network as their non-human actor. The use of the materiality standard was widely accepted and favoured by the witnesses testifying

at the 1981 hearings<sup>74</sup> and had overshadowed shortcomings of the concept. Thompson, chairman of the board of the Institute of Internal Auditors, explained that this concept was widely accepted as it had “long been accustomed to ... , and some ... [had] hidden behind the terminology materiality, admittedly” (United States 1981, p.479).

The SEC’s voluntary program findings were also that companies had not met this standard and that it was not covering the observed abuses initially giving rise to the FCPA (United States 1981, p.456). For instance, Burton, an actor in Proxmire’s network, a professor of accounting and finance, asserted that the materiality test was weakening the FCPA. A similar argument to that was made by the SEC during the hearings held in the 1970s and briefly discussed in chapter five. The addition of this test, as Burton explained, would have “essentially rob[bed] the act of its significance in this area” (United States 1981, p.456), as this test was biased “against small- and medium-sized businesses” (United States 1981, p.456) and that large corporations would be exempted “from their effect” (United States 1981, p.454). While, based on the 1970s hearings’ investigations, questionable payments were mainly found in large companies.

Illicit payments non-disclosure based on the view of the SEC was material to investors since these payments would have an effect on “corporation’s managerial integrity” (Brennan 1984, p.60). The GAO indicated the same finding that the materiality standard was “inappropriate to bribery” (United States 1981, p.4). It also concluded that adoption

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<sup>74</sup> Witnesses from the Emergency Committee for American Trade (ECAT), the Department of Justice, Institute of Internal Auditors and Financial Executives Institute (FEI) favoured the addition of this standard.

of such a concept by the Congress “could weaken the ... intent of the accounting provisions to enhance corporate accountability over assets” (United States & General Accounting Office 1981, p.90). The materiality concept, even though it is based on shareholders’ needs, fails to disclose illegal bribes entirely. The materiality concept was taken from the FASB’s 1980 definition. While the FASB had abandoned its materiality concept project after holding public hearings in this regard and had later advised to use individual judgement in this area. Also debates about the definition had already begun in the Senate by the introduction of S. 708 and demonstrated the confusion among the witnesses at the hearings held in 1981.

The addition of the materiality standard to the law was however noted by the witnesses from the Emergency Committee for American Trade (ECAT) as a tool for reducing the cost and “unjustified overreaction to the disclosures of the mid-1970’s” (United States 1981, p.141). This new accounting provision was perceived to be making the law “more accurate in its approach to the problem of overseas bribery of foreign government officials and more simplified in its enforcement and purpose” (United States 1981, p.43). However the AICPA representative argued the materiality standard, even though it was supported by them, depended on exercising “judgement in circumstances” and could not “be reduced to a precise formula” like the reasonableness concept which was already part of the act (United States 1981, p.346).

The SEC too had doubts in applying this concept to internal control provisions of the act, since materiality “in generally accepted accounting principles ... [was] not defined in the literature” (United States 1981, p.337). The GAO in their report also, pointed out

that materiality was not appropriate for assessing the adequacy of such systems (United States & General Accounting Office 1981). The SEC initiated the use of “the prudent man approach” as the definition of the materiality concept would be interpreted as application of only quantitative measures rather than including a qualitative testing as well (United States 1981, p.337). However, the previous SEC chairman, Hills, stated that both terms were similar in their approaches and that “neither standard properly catches the problem” (United States 1981, p.360).

Some of the witnesses considered the new provisions were solving one set of problems, but at the same time, creating another set of problems mainly for smaller organisations. This provision was going to include “[a] scienter provision” meaning that the law would only be violated if the books and records and the internal accounting controls were falsified intentionally (United States 1981, p.9). This provision was favourable as it was intended to eliminate the issue of corporations’ liability for the actions of their foreign agents abroad. The SEC and the AICPA were both in support of this amendment since 1976 when the act was recommended to the Congress.

The other amendment was regarding elimination of the SEC from its enforcement role of the bribery provision of the FCPA and having the DoJ as the sole civil enforcement body. Since the enforcement authority was extending its jurisdiction and it was not in relation to the SEC’s objectives in protecting investors. The argument was that this change would make the enforcement “consistent and predictable” (United States 1981, p.52). Also, having the Department of Justice issuing “clear and comprehensive guidelines” (United States 1981, p.53) as the SEC and the AICPA up to then had their

disagreements “as to a firm’s responsibility under the accounting provision of the law” (United States 1981, p.51). The proposed changes from Proxmire’s viewpoint were not going to be passed by his network and through the Congress “without a major fight” and a “strong educational debate on the floor” (United States 1981, p.5).

### 3.2.2 House of Representatives Hearings on the Bills Presented

The Senate hearings ended with S. 708 being modified based on the opinions of different witnesses and Senators such as Proxmire, Heinz and the chairman of the hearings, Senator D’Amato<sup>75</sup> (United States 1983a). The modifications were approved by the Senate as the thrust of the act which was prohibiting bribery had not changed and it made the act clear for corporations and enforcement agencies. Even Senator Proxmire and his network had reached a compromise and agreed to the new version of S. 708 (United States 1983a). The Senate passed the act by majority vote.

While these hearings were held during the first half of the year, the House of Representatives started its hearings in relation to the FCPA by September 1981. The Senate’s proposed bill to amend the FCPA was passed on to this committee and the chairman said it was “the greatest thing since sliced bread”, even though the language was still as vague as the original bill (United States 1982, p.257). The Senate bill was pushed to be approved by the House of Representatives at an “extraordinary high speed” (United States 1982, p.257). However, “key members in the House” of Representatives were not convinced with “the merits of the bill, despite [their] sustained negotiations throughout 1982” (United States 1983a, p.3). Negotiations were mainly

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<sup>75</sup> Senator D’Amato had stated this point during his opening statement.

between Senator Chafee and Congressman Wirth, democrat and chairman of the Telecommunications Subcommittee and actor in the Proxmire network, in relation to amendments of the accounting provisions of the proposed bill by the Senate (United States 1983a, p.3).

As the chairman, Wirth, put it at the initial hearing, there was “a Democratic caucus going on” (United States 1982, p.1). Wirth started the first day of the hearings by stating that this subcommittee would study and examine the effectiveness and impact of the act and the SEC and the Justice Department enforcement of the act, rather than “go roaring with the perception of a fix for a problem that isn’t yet defined, let’s first define the problem” (United States 1982, p.2). He wanted to define the shortcomings of the act and to amend it to be more explicit. Rather than acting the way the administration officials were, which was blaming the problem of “balance-of-payments ... on the Foreign Corrupt Practices Act, while neglecting to mention” the real problems (United States 1982, p.320). The pattern of the Congress legislating was to act on assumptions rather than hard data or facts (United States 1982, p.158).

The second and third day of the hearings followed the same theme as the first. The second hearing was in relation to enforcement of the act, where the SEC and the Department of Justice both reported the cases that they had investigated. The following hearing was in relation to the “impact of the act on American export performance” and the U.S. foreign relations (United States 1982, p.217). The aim was to separate the effects of the act on corporations’ sales and exports from “the alleged ambiguities” that were reported by different reports and surveys from 1977 (United States 1982, p.256).



These documents mainly included a report by the Carter administration entitled the 'Report of the President on Export Promotion Functions and Potential Export Disincentives' and the published result of 'a survey of business opinion' by the GAO entitled the 'Impact of Foreign Corrupt Practices Act on U.S. Business' (Koehler 2014; United States 1982, p.255). As stated earlier in this chapter, the report by the administration, similar to the GAO report, was mainly related to the FCPA being identified "as one of the most significant export disincentives ... because of uncertainty within the business community about the meaning and application of some of its key provisions" (United States 1980b, p.9), which "was dismissed by the Justice Department" (United States 1982, p.256). Wirth claimed the administration letters to the Government departments such as the State Department, were "prefaced with ... negative views of the act" as well as their intention to change the act (United States 1982, p.268). He believed the departments as "responsive, [and] good civil servants", were to be asked to "comment on the foreign trade impact of the FCPA" and to provide examples of the positive implications and shortcomings of the FCPA (United States 1982, p.268).

The Export Task Force report was used to explain the ineffectiveness of the act, stating a "\$1 to \$2 billion figure of lost exports" was from the enactment of the FCPA (United States 1982, p.228). The committee chairman however, believed that the reductions in exports were not mainly due to the act, as the figures were opinions rather than facts. He related the reductions to cuts in the U.S. "national commitment to research and development", as well as changes in inflation, value of the dollar and the budget deficit (United States 1982, p.228). Wirth stated that using this argument to suggest "that any

problems we have around the world in the trade area” are as result of the enactment of the FCPA and to push for amendments, was “disingenuous” (United States 1982, p.253).

Eckhardt, as he had argued in the 1979 hearings, claimed that the act would not be absolutely repealed but other methods would be “used these days to undermine what seems to me to be salutary legislation” which leads to the act having a weakened language and an enforcement ability which “when applied by a prosecutor ... it becomes virtually impossible to win a case” (United States 1982, p.4-5). The amendments were viewed by Clinard, research professor of sociology at the University of New Mexico, as “putting corporate profits before principles” and “endangering the political position of the United States” (United States 1982, p.64). However, this view was not shared by the witnesses from the Government departments such as the Department of Commerce or the Department of State. The accounting provisions were perceived by Unger from the Department of Commerce to be creating a “substantial burden on all U.S. business” and there was a need for this provision to be eliminated from the act (United States 1982, p.305).

The panel of witnesses<sup>76</sup> on the initial hearing, agreed that the accounting provisions of the act came into place to send a message across to the companies that “they would be held accountable for proper management of the corporation” (United States 1982, p.101). They wanted to keep the message intact, and not to amend the act contrary to the

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<sup>76</sup> The panel of witnesses included Pollack, Hills, Clinard, Akins, former U.S. Ambassador to Saudi Arabia and Blum, former counsel to the Senate Subcommittee on Multinational Corporations (United States 1982, p.8).

already established governance systems and codes of ethics of corporations since the enactment of the FCPA. The disclosure and accountability as described by Pollack, former SEC Commissioner, were based on the “core of the Commission’s thinking” and became the foundation of the actions that the Congress took in the 1970’s against the problem of questionable payments (United States 1982, p.101).

### 3.3 1983 Amendments of the FCPA

#### 3.3.1 Senate Hearing on the Bills Presented

As the Senate bill, S. 708, was not passed by the House of Representatives, by February 1983 the Senate reintroduced the bill with the support of the Reagan administration and administration network. The reintroduction was, according to Senator Heinz, to stop shooting themselves in the foot (United States 1983a, p.3). This reintroduction of the Senate passed bill was due to the fact that the full Senate had believed that it was “an acceptable improvement” (United States 1983a, p.3) over the existing FCPA “without significant controversy” (United States 1983a, p.4). It was argued the reintroduction of the bill was going to help the U.S. export and economy as it was widely agreed upon by witnesses from the Government and the administration (United States 1983a, p.42).

The identical bill reintroduced by the Senate, S. 414, was called the “business accounting and foreign trade simplification act” (United States 1983a, p.1). The chairman of the Banking, Housing, and Urban Affairs Committee, Senator D’Amato, announced his opposition to any new major changes to S. 414, as corporations were continuing to lose sales and export opportunities. Senators Heinz and Chafee too

wanted this bill to be enacted as in their judgement the uncertainties were real and the impact on U.S. citizens was that they were losing jobs, and wages (United States 1983a, p.3 & p.42).

The S. 414 accounting provisions were to some extent modified based on the SEC's recommendations and had substantially narrowed the difference between Shad, the then SEC's chairman, and Senator Chafee's position on this provision, as will be shortly explained (United States 1983c). But Shad in a letter to Senator Chafee claimed that he was "discouraged" by the amendments as the final version of the provision appeared "to be several steps backwards - conceptually - from" the latter Senate hearings and previous discussions (United States 1983c, p.210). According to Shad, the problems stemming from the act were essentially misinterpretations and "misconceptions about what conduct may be prohibited by its provisions" (United States 1983c, p.210). Nevertheless, the attitude at the 1983 Senate hearing was that the newly proposed bill was simplifying and improving the accounting section and not necessarily reducing its effectiveness (United States 1983a).

The major changes to the accounting provisions were in relation to the internal accounting system requirements, as the recordkeeping requirement was merged with this requirement. S. 414 required corporations to "provide *reasonable assurance* that the statutory objectives of their internal accounting controls are met" (United States 1983a, p.48, emphasis added). This amendment was based on the SEC's request to add a prudent man standard to the bill which took into account a cost-benefit analysis. The bill included two new sections, one related to issuers being subject to a "good faith" test and

the other stating that “[n]o person shall knowingly circumvent a system of internal accounting controls established” (United States 1983a, p.12). Circumvention was added as it was intended to include the use of off-the-books slush funds and deliberate falsification of the books and records to escape the internal control requirement. As per the request of the SEC and other witnesses, the bill eliminated imposition of any civil injunctive or “criminal liability ... for failing to comply with the [accounting control] requirements” (United States 1983a, p.11), if it could be shown “that it acted in good faith in attempting to comply with the internal accounting controls requirements” (United States 1983a, p.51).

The witnesses at the hearing had all testified at the 1981 Senate hearing. They all still, as part of the administration network, believed that the FCPA needed to be modified and that the proposed bill was sufficient and clear to restore U.S. growth in its economy and exports. The committee chairman in the end congratulated Proxmire “for his willingness to consider language” that from his viewpoint was to be “more practical and more beneficial to the public in its application” (United States 1983a, p.107). Proxmire and his network were captured by the rhetoric that the administration network had used in persuading the acceptance of the bill by the Congress. The Proxmire network had no power or leverage in comparison to the Reagan administration and the backing of business in enrolling new actors or keeping the network active.

### ***3.3.2 House of Representative Hearings on the Bills Presented***

Congressman Dan Mica introduced H.R. 2157 in March 1983 to the International Economic Policy and Trade Subcommittee. The bill was called the “Foreign Trade

Practice Act” as it reflected a “neutral title ... in this area” (United States 1983b, p.3). The bill’s content was similar to the Senate S. 414 bill, but it differed in two respects. One aspect was the fines and penalties for the violation of the act were double the Senate bill. The other difference was that the Department of Commerce was in charge of administrating the accounting provisions instead of the SEC. The Department of Commerce would have been in charge of “investigating violations of the disclosure requirements of the Federal securities laws” (United States 1983b).

The witnesses at the initial hearings were similar to those at the Senate hearings and they had the same message. The message was that they were all against bribery but the FCPA needed to be amended as it was vague and costly to American businesses. The evidence that was presented was mainly referring back to the GAO’s survey in 1981 which was based on businesses opinions rather than trade statistics. However, the hearings did not include any arguments in relation to shortcomings of the proposed amendments or that it was weakening the FCPA or the ability to enforce it.

There was no discussion of the effectiveness of the FCPA as it was enacted in 1977. Brennan, Associate Professor from the Bowling Green State University, concluded from his interviews<sup>77</sup> that the Congress had to initially reconcile the conflicting views in relation to the FCPA and the proposed amendments in the eyes of the American public. Since many still believed that the FCPA in its current format was “fair and just” (United States 1983b, p.250). Brennan stated this viewpoint had to be discussed in the hearings

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<sup>77</sup> Interviews were done amongst 34 men and women in the public and private sector regarding the impact of FCPA.

or that the public would perceive the Congress “gutting” the FCPA to benefit the business community in the short run and leading to “more stringent legislation in the future” which could result in legislation that “sends the wrong signals to the public and private sector and international business conduct of American multinationals returns to pre-FCPA patterns” (United States 1983b, p.250). This is while the public confidence in enforcement of the FCPA had been to some extent shattered as the Justice Department was no longer reporting its enforcements of the act to “the Multinational Branch of the Criminal Fraud Division” (United States 1983b, p.250), because of the Administration’s elimination of this branch, in 1981. Further, as detailed in this chapter, the SEC had dramatically reduced its enforcement priorities of the FCPA.

The accounting provisions of H.R. 2157 were word for word taken from S. 414. The main focus and interest of the House of Representatives hearings was on the anti-bribery provisions of the act as opposed to the accounting section. Mathews, a former SEC commissioner, during the last hearing raised concerns in relation to omission of the recordkeeping section and being part of the internal control requirements. He wanted the legislation to include “a Federal violation” for knowing falsification of “the books and records of a corporation” or cooking the books to have an effective law in place (United States 1983b, p.227-228). Cooking the books either to conceal an illegal act or illicit payments as described by Moore was an intentional alteration of the books and records which is against the law and accounting principles (United States 1983b, p.289).

### 3.4 1985-1986 Amendments of the FCPA

During February 1985 the Senate reintroduced S. 708 and S. 414 as S. 430. The bill was initially referred to the SEC, the Department of Justice and the Department of Commerce. By June 1986 the Subcommittee on International Finance and Monetary Policy and the Subcommittee on Securities jointly held a hearing in relation to this bill. Proxmire, during his opening statement, was trying to re-establish his network and again asserted his disagreement with the bill naming it the “bring back bribery” legislation (United States 1986, 20). He believed that the push for amendments had come from “the Reagan administration, joined by a vocal group of trade lobbyist” (United States 1986, p.38). Again, the amendments to the accounting provision were only criticised by Proxmire and Mathews.

The main criticisms were in relation to elimination of criminal liability and inclusion of the books and records provisions as part of the internal accounting control section. Mathews argued S. 430 would “needlessly curtail the SEC’s effectiveness in so-called ‘cooked books’ cases” as corporate officers or employees would be able to falsify their accounts and books due to the fact that the amount is immaterial to the corporation’s financial statements or that it is not “contrary to management’s general or specific authorization” (United States 1986, p.119). The bill requirements included “the Attorney General and the SEC Commissioner to make yearly reports on all activities under the FCPA” encouraging “the President to seek an international treaty on illegal foreign payments” (Longobardi 1987, p.455).



By September 1986, the Senate Committee on Banking, Housing and Urban Affairs agreed to report the bill, but no further action was taken before the end of the Congress session. Congress and the House of Representatives during 1986 had considered “at least four bills containing amendments to the FCPA” (Longobardi 1987, p.454). These proposals were mainly identical to the bills that were presented to the Congress in previous years however, the bills all died with the end of the Congress. For instance bill H.R. 4389, was introduced in 1986 which was similar to H.R. 2157. The bill “would have amended the Export Administration Act of 1979 ... [and] have omitted the accounting provisions of the Act entirely” (Longobardi 1987, p.456). The bill was later adopted into H.R. 4800, the Trade and International Economic Policy Reform Act which “did not disturb the accounting provisions” of the FCPA or its original structure (Longobardi 1987, p.457). H.R. 4800 according to Longobardi (1987, p.459) “was a tremendous improvement over all prior bills proposed to amend the FCPA”. The above bills were not supported by either the Senate or the House of Representatives, due to their emphasis on “the consequences of bribery rather than the nature of the act” (Brennan 1984, p.82).

#### **4. The Final Result of the Hearings**

By 1988, the Congress included the amendments to the FCPA as part of title v of the Reagan administration’s Omnibus Trade and Competitiveness Act (OTCA) of 1988 which was introduced in 1987 as H.R. 3. The OTCA was an “approximately four hundred page piece of legislation” of which the amendments to the FCPA were only six pages (Brennan 1990, p.230). The Administration network can be argued to have been unsuccessful in directly weakening mainly the accounting provisions of the act. OTCA

was the only resort this network had, to be able to move through the phases of the translation model as well as keeping the actors enrolled. The amendments were “a compromise on changes to the FCPA” that was initially proposed by Chafee and “supported by business-group lobbyists and the Reagan administration” (Guterman 2013, p.15). Section 352 of H.R. 3 was identical to H.R. 4800 that was not passed by the Senate at the end of 1986. The provisions in relation to the FCPA “were sandwiched into the lengthy and more controversial provisions of the OTCA, thus escaping significant public scrutiny” (Earle 1989, p.550).

Even though the majority of the criticisms focused on the accounting section’s shortcomings, the amendments were in relation to the SEC’s recommendations relating to clarifying the accounting provisions by defining the ‘reasonable detail’ and ‘reasonable assurance’ (Fremantle & Katz 1989; Sheffet & Calantone 1993). The bill also included limitation of “criminal liability for violations of accounting standards to those who knowingly circumvent a system of internal accounting controls or who knowingly falsify records kept pursuant to accounting requirements” (Fremantle & Katz 1989, p.765). This limitation, as argued by Cragg and Woof (2002, p.186), was a “corporate friendly” provision which “made prosecutions more difficult by stipulating that officers of firms offering bribes must be proved to have direct knowledge that payments were being used for illicit purposes”.

Having the amendments had not reduced the SEC authority to regulate as well as oversee the internal management of domestic companies (Bathen 1978; Dundas & George 1979-1980). For example, by July 1988 the SEC re-introduced a previously

withdrawn proposal regarding the management statement on internal accounting control (Solomon & Cooper 1990). The proposal was called the 'Report of Management's Responsibilities'. As argued by Solomon and Cooper (1990, p.56) "[f]or over a decade, financial statement preparers and auditors as well as legislators and regulators have advocated" the use of such a report. The old rule was proposed initially in 1978 based on one of the Cohen commission report's recommendations, as discussed in chapter six. It required management to prepare a statement to form their opinion regarding the control systems providing

reasonable assurances that specified objectives ... were achieved; and ... description of any material weaknesses in internal accounting control communicated by the independent accountants ... which have not been corrected, and a statement of the reasons why they have not been corrected (Stanger 1980, p.88-89).

It also required "an independent accountant examine and report on the management report" (Grundfest & Berueffy 1989, p.14). The withdrawn proposal had a "close correlation between disclosure of management's opinion on internal control and compliance (or the lack of compliance) with the internal accounting control provisions of the FCPA" (Grundfest & Berueffy 1989, p.14).

The new rule was as well in response to the thirteen recommendations made by the Treadway Commission report (Relevant details pertaining to the Treadway report will be explained in the following section) which required rulemaking by the SEC (Black 2012; Grundfest & Berueffy 1989; Securities and Exchange Commission 2002; Solomon & Cooper 1990). The rule required registered corporations to include in their publicly available report a 'management report' to demonstrate the effectiveness of their internal control systems as well as "management's stewardship responsibilities" (Bagby

1983, p.222; Fremantle & Katz 1989; Grundfest & Berueffy 1989; Solomon & Cooper 1990). The purpose of the report was for management and independent auditors to disclose an acknowledgment of their responsibilities in relation to financial statements as well as establishment and maintenance of the company's internal accounting control system (Fremantle & Katz 1989; Michael 1980; Securities and Exchange Commission 1988; Securities and Exchange Commission 2002). Management responsibilities would have extended to describing and assessing the "actions taken in response to recommendations made by internal auditors and independent accountants" (Boury & Spruce 2005, p.30; Securities and Exchange Commission 2002). The management report was proposed by the SEC in the hope of helping auditors in finding "material misstatement of facts" and any shortcomings of the internal control system (Fremantle & Katz 1989; Securities and Exchange Commission 1988, p.2).

This proposal was again withdrawn by the SEC in the 1980s (Boury & Spruce 2005) "after an unprecedented outcry from both the auditors" as well as American corporations not supporting the proposal (United States 1985, p.574). It was withdrawn "after the Auditing Standards Board of the AICPA issued its position statement on this matter" (Cascini & Vanasco 1992, p.25). The SEC issued ASR No.278 instead, which required companies to voluntarily report on their internal accounting control systems. The management report was later reconsidered by the Treadway commission. In 2002, the management comprehensive review and report of the internal control and the "public accounting firms attesting to" this report was included in the SOX act, section 404 (Moeller 2004, p.105). The SEC had defined the term internal control, of section 404, in reference to the Treadway Commission established framework in this regard.

The withdrawal of this proposal was partly related to the Department of Justice showing a willingness to provide guidelines on the act in helping the users to better understand the complexities of the law (Bagby 1983; Cascini & Vanasco 1992). The DoJ had released ‘the FCPA Review Procedure’ which provided their opinion and advice only “on the legality of the contemplated transaction”, on a case-by case basis, as well as protection of corporations “from disclosure of sensitive information under this procedure” (Cascini & Vanasco 1992, p.25; Lochner 1980). However, the DoJ advice was not mainly related to clarifying and explaining the accounting provisions of the act. This was because the SEC had decided to not join this review process (Cascini & Vanasco 1992).

## **5. The 1980s Corporate Failures**

The lack of enforcement and guidelines for the accounting provisions of the FCPA, as previously explained in chapter six, as well as accounting issues surrounding corporate failures and audit frauds during the 1980s, led to three years of hearings named ‘SEC and corporate audits’. The hearing held by Rep. John Dingell, were related to “the adequacy of the accounting profession’s self-regulatory system” in setting accounting and auditing standards (Holtzman 2004, p.952; United States 1985; Zeff 2003b, p.273). This climate of criticism and scrutiny of the accounting and auditing profession initiated the formation of the National Commission on Fraudulent Financial Reporting in June 1985.

A Commission, a private sector initiative, known by the name of its chairman, James Treadway, former SEC Commissioner, was established to identify and improve “ways to better prevent and detect” management fraud so that “the auditing profession and business community can better assure the public that the system of corporate accountability is credible” (United States 1985, Part 6, p.65). It was “jointly sponsored and funded by five private accounting organizations” including the AICPA, the American Accounting Association (AAA), and the Institute of Internal Auditors (IIA) (Grundfest & Berueffy 1989, p.2; United States 1985, Part 6). The AICPA provided “major funding and support” (United States 1985, Part 6, p.65). The Treadway Commission formation was announced during the last ‘SEC and corporate audits’ hearings.

### 5.1 The ‘SEC and Corporate Audit’ Hearings

Dingell, Democrat and chairman of the Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce, during the first day of the hearings stated that the purpose of the hearings was to investigate “the effectiveness of independent accountants who audit publicly owned corporations and the effectiveness of the Securities and Exchange Commission which audits those accountants” (United States 1985, Part 1, p.1). Similar to Metcalf, Dingell also raised questions and concerns in relation to auditors’ independence in providing services to their clients as well as the SEC’s reluctance to use its powers granted by the Congress “to address problems in standard-setting and audit enforcement” (United States 1985, Part 1, p.3). The SEC was also questioned for defaulting “on its responsibility to establish an independent system of overseeing auditors” (United States 1985, Part 1, p.449). The subcommittee chairman

was urged not to let the “accounting establishment ... beat this committee” just as they had taken “on the Metcalf committee and they beat the Metcalf committee, ... they took on the Moss committee and they beat the Moss committee” (United States 1985, Part 1, p.729).

The first witnesses on the first day were Briloff and Chatov, who had previously testified and helped with the Metcalf and Moss investigations, as detailed in chapter three (Holtzman 2004; United States 1985; Zeff 2003b). They both argued that since their last testimony at the Metcalf and Moss hearings, “not a great deal of change ... [was] manifested” (United States 1985, Part 1, p.6) and that “the more things change, the more they remain the same” (United States 1985, Part 1, p.70). Chatov added

I believed in 1977, and I do today, that irrespective of good will and integrity on the part of different individuals, that the system itself simply is not capable of self-reform. It has got to be changed if you want something different (United States 1985, Part 1, p.7).

The chairman of the committee believed the system that “was established more than 50 years ago to safeguard ... [the] economy from financial abuses and illegal business practices” was not working (United States 1985, Part 4, p.1). This is because the external auditors who are

trusted blindly [by the stakeholders] ... are like the necromancers and sorcerers of old. Nobody knows exactly what they are doing. There are vast clouds of smoke and lots of waving of arms and incantations and adjurations, occasionally a flash of light moves through the scene (United States 1985, Part 1, p.286).

The arguments of Chatov and Dingell were similar to what Proxmire had initially stated during his hearings regarding the illicit payment issue. Proxmire had emphasized that the problem was the system that was not working (United States 1976l). While the

AICPA and the SEC, like in the 1970s, denied these claims. The SEC stated “[t]he system is extremely cost effective” in bringing a “record number of cases” (United States 1985, Part 1, p.568). The AICPA believed the audit failures were

as the result of human error ...[not] a breakdown in the system. ... We think we have a very powerful system ... that is designed to assure the Congress and the public that the Nation’s auditors are able to discharge their responsibilities in an efficient and effective manner (United States 1985, Part 1, p.920).

The role of independent auditors and their incompetence in providing warnings about corporations’ bribing foreign officials was raised by Chatov. Reasoning that either

auditing is corrupt and auditors look the other way when they discover irregularities ... [or] more likely, because of the sampling system ... that it is relatively easy for insiders to hide what they want from outside auditors (United States 1985, Part 1, p.9).

Briloff, Seidman, chairman of the Federal Deposit Insurance Corporation, and Bowsher, Comptroller General of the U.S. GAO, also believed that auditors, as part of their internal control review should be looking for financial fraud and illegal activities. Fraud detection and internal control evaluation had been part of the government auditing standards, as part of GAO’s duties to audit government agencies’ financial reports, since the 1970s<sup>78</sup> (United States 1985, Part 6). Auditors’ duty of reporting illegal activities to government regulators was recommended in the 1970s by the Metcalf Subcommittee but was never implemented by the accounting profession (United States 1985, Part 6). The only standards that were implemented by the profession were SAS 16, and SAS 17, as briefly described in the previous chapter, that were both effective as of January 1977.

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<sup>78</sup> Also as part of the Single Audit legislation requirements.



Briloff raised concerns with the independent auditors' responsibility to the public and stakeholders arguing "the profession's traditions and, I submit, its present role and responsibility to society are better defined as a 'private priesthood'" (United States 1985, Part 1, p. 85). This was because the phrases used by the auditors in their report would not convey the reality that a lay reader would observe and understand. Referring to Burton, he defined auditing practices as a commodity, providing tax and management services to increase their profits and abandoning their traditional services on behalf of society (United States 1985, Part 1). As advised before, in the 1970s, Chatov recommended the use of auditors provided by the Government to protect the public interest. As well Manson<sup>79</sup>, the then chairman of the National Conference of CPA Practitioners<sup>80</sup>, urged the subcommittee chairman to "consider the formation of a Federal Board" of Public Accountancy as an initial step to reform of the profession (United States 1985, Part 1, p.729).

Briloff's testimony was also related to recent corporate failures being partly due to their internal control system being "corroded or corrupted" (United States 1985, Part 1, p.74) even though "the Congress had given legislative approval ... to auditing standards pertaining to internal control" as part of the FCPA (United States 1985, Part 1, p.103). The FCPA was enacted in the hope of companies "sufficiently or significantly upgrad[ing] their internal audit function" (United States 1988, Part 1, p.214). However, "this new cloak of authority and legitimacy for ... [the] profession was too heavy for ... [their] shoulders" and like corporation management and "their stalwart professional

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<sup>79</sup> Manson had previously served as the vice president of the AICPA and a member of its Executive committee for nine years.

<sup>80</sup> An organisation established "to preserve the viability and protect the interest of regional, medium-sized and local accounting firms" (United States 1985, Part 1, p.730).

representatives”, had resisted “the endeavors by the Securities and Exchange Commission to implement the legislation” (United States 1985, Part 1, p.103). Despite the fact that the accounting provisions of the FCPA “were watered down” as observed by Briloff (United States 1985, Part 1, p.103).

A new piece of legislation H.R. 4886 addressing auditors’ duties towards detecting fraud and illegal activities, was developed by several members of the subcommittee including Senator Wyden and the committee chairman. It was discussed during the last days of the hearings. The main concern was the enforcement of the act and the SEC’s ability to investigate more cases. Bowsher stated that it was “all a case of getting leadership and action” by the profession and not just forming study groups such as the Cohen Commission or the Treadway Commission (United States 1985, Part 6, p.30). The Treadway Commission was argued by the present Senators at the hearing, Luken and Wyden, to be going down the same road as the other study groups such as the Cohen Commission and looking at “the age-old problem” concerning independent auditors and their duties towards reporting fraud and illegality (United States 1985, Part 6, p.79).

The AICPA however, believed that the legislation should be abandoned as it would “not improve ... [the auditors’] ability to serve the public interest” and that the study group would accomplish this goal as it was an act from “within the existing regulatory and supervisory framework” (United States 1985, Part 6, p.110). Shad, the then SEC chairman was also not supporting the proposed bill due to the accounting profession’s efforts in this area and the increase in cost for auditors that was not justifiable and

guaranteeing the reduction in audit failures and corporate frauds (United States 1985, Part 6). As part of his testimony he stated “[a]uditors are not lawyers or regulators. They do not presently have the expertise or tools to detect possible illegal or irregular acts that are not related to the financial statements”, but are related to internal control systems (United States 1985, Part 6, p.288).

By 1987, when the findings and recommendations of the Treadway Commission were issued, members of the subcommittee had mainly praised the commission’s effort. Dingell stated that the report had diligently addressed “the question of what causes fraudulent financials and what can be done to reduce their incidence” (United States 1988, Part 1, p.1-2). While there were some concerns among Senators about the recommendations’ ability to make any changes to auditing practice and management responsibilities, to report was argued by Wyden to be optimistic since during the last decade,

[t]here was a unanimous Senate committee report calling for the very things that are proposed in my legislation. Ten years ago there was a flurry of reports, commissions, and studies not all that different than what we are seeing now. Somehow, in the real world, things didn’t change much. I am very hopeful ... that something is going to be different this time (United States 1988, Part 1, p.41).

Because the report’s recommendations were comprehensive and covered parts of the content of H.R. 4886, Treadway advised the Congress to wait until the substance of the report was significantly implemented before passing the proposed legislation. The AICPA had initiated reviewing and revising their standards in relation to independent “auditor’s responsibility for the detection of fraud”, and increasing their communication of information pertaining to the audit process and business failure to stakeholders (United States 1988, Part 6, p.160). The chairman was hopeful that the profession would

“clean up its own shop so that further legislation” would not be needed (United States 1988, Part 1, p.99). However, as it is clear from the corporate collapses that took place in the early 2000s, these recommendations, like previous recommendations, were mainly window dressing. During 2002, the Congress once again had to step in and take charge of passing legislation that would seemingly put a stop to corporations’ corrupt and fraudulent activities. As argued in this study, the lessons were not learned and the history of corporations’ lack of accountability and responsibility to stakeholders repeated itself.

## **6. Conclusion**

The FCPA, from its inception, was under broad attack by the administration who had signed it into law; as well as the business community. The main reason was the perceived effect of this legislation on corporations’ business internationally and creation of export disincentives for them. The FCPA was viewed as an unproductive regulation having adverse effects on the U.S. economy and foreign affairs. When Reagan became the U.S. president, he had the same agenda, namely, in his words, getting the Government off the back of Americans or mainly American businesses. His promotion of free market and deregulation meant that he was willing to let the corporations’ bribery and corrupt activities go by without any penalties. For this reason there was a push by the White House to amend the provisions of the FCPA.

The amendments to the act were mainly directed towards repealing the accounting provisions of the act. It was mainly supported by Reagan, his administration and the

U.S. corporations, while at the same time trying to “distance themselves from the appearance of condoning bribery” (Guttermann 2013, p.27). However, some of the Senators and Congressmen such as Proxmire, Eckhart and Wirth believed the original legislation was effective. The proposed bills for amending the FCPA “became the subject of legislative controversy in Congress for ... seven years” (Guttermann 2013, p.13). The bills presented to the Senate and the House of Representatives wanted to either weaken the FCPA in total or to remove the accounting provisions altogether. The argument was that the presented bills would have eliminated the vagueness and overly broad provisions of the FCPA. The amendments would also have eliminated the perceived unjustified competitive edge that businesses had over foreign businesses. However, “despite continued support from business groups ... it did not survive” as a separate bill (Guttermann 2013, p.13). A compromise of the proposed changes by the Chaffee bill was passed as part of an around four hundred page piece of legislation called the U.S. Omnibus Trade and Competitiveness Act of 1988 (Brennan 1990). The goal of the act was, at best, to indirectly amend the 1977 FCPA (Brennan 1990), which was not what American corporations were hoping and lobbying for.

While the Congress can be argued to be successful in passing legislation to curb corruption and bribery, they had failed in enforcing the law. As explained in this and the previous chapters, the political, legal and economic forces of the time had a negative effect on the enforcement and prosecution of corporations. The 1980s and 2000s corporate failures can partly demonstrate the ineffectiveness of the FCPA and its enforcement. Apart from enforcement issues, there were shortcomings with the auditing profession in executing their responsibilities and their providing warnings about

corporations making illicit payments. The SOX act similar to the FCPA, was a cosmetic fix, and was passed in 2002 to put an end to these shortcomings and issues, while not taking into account that the underlying problem was with the disclosure and corporate accountability system that was not working effectively. The next chapter will conclude the lessons that were not learned by the politicians, the SEC and the accounting profession, from the enactment and enforcement of the FCPA.

# Chapter Eight: Lessons to be Learned

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*Law may often be part of the problem of corruption. Too many laws, excessive formalism, and vexatious procedures help create corruption (by forcing people to get around them) and weaken attempts to control it. Law may encourage corruption by setting artificially low limits to political expense (Nelken & Levi 1996, p.9)*

The Foreign Corrupt Practices Act, as a political affair, was signed by President Carter in 1977, after two years of congressional hearings and legislative proposals. The act as described by Longobardi (1987, p.432) was “one of the United States’ most controversial federal laws”, although its “overall effect appears to be modest” (Darrough 2009, p.266). The Bills presented to the congress for this purpose represented the urge by Congress to do something about overseas and domestic bribery and questionable payments that were revealed during the investigations of the Watergate break-in. Moran (2010, p.220) states that “under a highly competitive political system” some of the legislators would be “constantly searching for scandalous regulatory failures to remedy”. The bills had “caused such emotional debate” that only a few other national and international bills had evoked (Brennan 1984, p.56). The Watergate scandal and post-Watergate findings by the press had helped to publicise the events that were perceived by some to be “a breakdown in moral values throughout society” (Williams 1985, p.1). As argued by Davis (2012b, p.498) moralism and partly self-interest “played the most significant roles in shaping the original Act and its 1988 amendments”.

## 1. Magnitude of the Problem at Hand

Senator Williams on the senate floor stated,

no one expected at the beginning of these hearings that corruption of such magnitude and at such high levels would be documented. No one expected that such disregard for good ethics and good business practices existed in the conduct of American overseas business (United States 1976d, p.30425).

In brief

[t]he response to Watergate was a powerful political force that built on all that came before Watergate. And what it ultimately produced was an array of ethics laws, rules, and procedures that had no precedent in the United States or in any other country in the history of the world (Mackenzie & Hafken 2002, p.35).

The Congress was swift in reacting to the prevailing problem of widespread illegal use of corporate funds domestically for President Nixon's re-election campaign and internationally. It became apparent that the problem of political contributions and payments "were not isolated occurrences but a way of doing business" in a majority of corporations (Neumann 1980, p.63). From the early 1970s, hearings were held in relation to the Watergate scandal, multinational corporations' wrongdoings and the way of doing business internationally. The outcome of the congressional hearings was the twenty legislative recommended proposals addressing the issue of illicit payments and restoration of confidence in the integrity of American companies.

The SEC also embarked on a Voluntary Disclosure Program to investigate publicly traded companies for the bribery of foreign government officials. The program had put the corporations in charge of determining and reporting the foreign payments that were deemed significant (material) to their stockholders. The SEC focus was the deception of



shareholders through payments made mainly from off-the books slush funds or improper invoicing practices. In many instances the failure to provide shareholders with accurate financial statements represented violation of the reporting requirements of the Securities Exchange Act of 1934 (Longobardi 1987; United States 1976n).

The voluntary program changed the SEC focus to corporate accountability. The SEC maintained that the integrity of the system of corporate accountability was related to the investors' right "to have accurate financial information on which to base a prudent investment decision about a company" (Bill To Ban Overseas Corporate Bribes Dies 1977, p.1). As identified by Koehler (2012, p.961), during the congressional investigations and hearings, the SEC, as a political institution<sup>81</sup>, "played the most prominent and trusted role" as well as

the most curious as the commission was a reluctant actor in Congress's quest for a new and direct legislative remedy to the problem. It is clear from legislative record that the SEC wanted no part in policing the morality of American business or in determining what is an improper foreign corporate payment.

The voluntary program also came to an end not because the active cases by the enforcement division were finalised, but because of pressures from the commissioners and the business community (Sporkin 2006). As explained in chapter four, some of the commissioners were eager "to put the cap on this volcanic situation" (United States 1976i, p.20). Corporations, on the other hand were indirectly lobbying for the discontinuation of the program, as they did not want to be seen as supporting "foreign corrupt practices" (Siedel 1981, p.443)

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<sup>81</sup> As explained in the previous chapters, the SEC is "an institution that changes with the political winds" (Pollack 2003, p.26).

## 2. Corporations' Role in the Formation of the Act

The act was intended to serve as an expressive function telling corporations' managers that corrupt payments are immoral. As argued by McCloy, in chapter two, the American corporations were supposedly over victimised in the process of congressional investigations while they were in the process of reforming itself. Nevertheless, from the twenty first century corporate collapses it can be argued that the act had not provided much of a deterrent effect or significant bearing on corporate behaviour (Cragg & Woof 2002; Hess & Ford 2008). The agency issue, separation of corporation's owners and managers, has created a unique design that is "a recipe for corruption and scandal" (Bakan 2012, p.6). Corporations and managers specifically, are in theory socially responsible for their stakeholders. They rely on portraying themselves as being seen to subscribe to a moral imperative, in maximising shareholders wealth and corporation's profit, in fact they are immoral. Berle and Means (1991, p.2) have described management as "princes of industry", and that no other power exists to control them. Corporate interests in relation to corrupt and fraudulent activities, have mainly been about funding to train employees in relation to matters pertaining to compliance with provisions of the FCPA. They also have employed "a substantial number of lawyers and internal auditors who do nothing other than FCPA compliance work" (Cragg & Woof 2002, p.100). Sporkin (2006, p.1), the then enforcement Chief, in one of his speeches in relation to the effectiveness of the FCPA stated

What I envisioned when the law was enacted was a new corporate regime where bribery of foreign officials would be almost completely extinguished at least as it pertained to major U.S. corporations. As all of us here observed, the wild-eyed-do-gooder predictions never occurred. Instead statistics indicate that bribery of foreign officials has maintained a steady pace over the years.

### 3. Issues Concerning the Accounting Provisions

Based on the legislative and political history described in the previous chapters, the accounting provisions had broad objectives, with the hope of discouraging “repetition of the serious abuses which the Commission ... uncovered in this area” (Securities and Exchange Commission 1979b, p.1143). Hills, the then SEC’s chairman believed the lessons would be learned by a corporation’s management, as the provisions were hoped to be strengthening corporate accountability and responsibility to their stakeholders. The act was regarded by the Congress as “a fundamental tenet of the corporate enterprise system” with the objective of fostering “integrity in the process of corporate management” (Black 2012; Goelzer 1979, p.19). This was because, improper payments were alleged to be a symptom of “weak corporate accountability and governance mechanisms which transcended the disclosure requirements of the securities laws” (Goelzer 1979, p.6).

However, the accounting provisions did not include any new requirements or disclosure requirements for corporations (Lesser 1979b). As argued in previous chapters, the provisions were not worded strongly partly due to political influences and a lack of accounting profession leadership and support. The lack of support, as pointed out in chapter three, can partly be related to the AICPA being dominated by the then accounting firms that had extraordinary influence over corporations and the government. The FASB also was financed by the business groups, especially large corporations, and the then accounting firms. The funding structure as briefly explained in chapter three, was the means of controlling and aligning the accounting bodies and profession’s interest. The funding was a way of keeping the government regulations at

bay, which can be argued to have led to the detriment of the integrity of the accounting records.

As stated by Lesser (1979b, p.183), no “standard of tight management control of corporate expenditure” was included in the provisions and then only included “mandatory minimum accounting standards under the guise of enforcing the criminalization provisions”. The provisions were restricted to publicly traded companies, as the Congress did not have the power to “instruct the private-sector standard setter to issue, or not to issue, a particular standard” while only having the ability to “pass legislation directing the SEC not to require that listed companies implement any such standard” (Camfferman & Zeff 2011, p.302).

For instance, the concept of an internal accounting control system was not new for the accounting profession, as corporations during 1960 and 1970 had some kind of a system in place. The FCPA explicitly imposed the internal control system requirements on corporate management. The internal control system of companies plays an important role in indicating where the responsibility lies and what is happening within a company, which is important from the perspective of management and stakeholders with an interest in the company. However, the main issue was in relation to the ability and effectiveness of this system in minimising management and employees’ wrong doings. As was explained in chapter seven, similar issues resurfaced during the 1980s, even though the FCPA was passed. The corporate failures during this time period also, were partly related to corporations’ internal control system being corrupted, as was demonstrated by the cases described in chapter two and four. The problem was that the

accounting industry and the corporate executives were vigorously opposing the mandatory control system requirements (Matson & Shapiro 2005). The other problem was with the ability of management in circumventing the control system and not to be easily held accountable for their wrongdoings, which was the circumstance in some of the cases investigated during the different congressional hearings in the 1970s. Circumvention of internal control would be preventable by having “effective corporate governance through independent boards of directors and external auditors” and not just having a system in place (Darrrough 2009, p.257). Approval and review of the internal control system by the board of directors or external auditors would have supplemented the provisions of the act, as well as minimising the corporate scandals during the 1980s and 2000s.

The accounting provisions also did not contain clauses pertaining to alteration of “the auditor’s duty to his client or the purpose of his study and evaluation of internal accounting control” (Rocco 1999, p.178). The problem of bribery and kickbacks was not a new one and the accounting profession had recognised it. For instance, during 1939 a company called McKesson & Robbins had regularly overstated its assets by using fictitious documents and recordings, which were not detected by the external auditors (Olson & Wootton 1991). The issue was that “no wealth of authoritative guidance for the auditor” was available at the time (Solomon & Muller 1977, p.51). The auditing standards and pronouncements were mainly tackling the “philosophical aspects” of the issues at hand, though not offering any “practical guidance” (Solomon & Muller 1977, p.51). As early as 1938, the auditing or accounting standards issued and developed by the accounting profession, were not approved by the Congress (Olson &

Wootton 1991). The Metcalf Committee, as discussed in chapter three, and the hearing held by Congressman Dingell, explained in chapter 7, were among the many congressional hearings held questioning the adequacy of the independent auditors' duties and function in protecting the public interest. The recommendations by these hearings however, were not implemented by the accounting profession or the SEC, as part of the FCPA or a new standard.

The shortcomings of the FCPA accounting provisions was that these provisions, on their own would not deter bribery, since corporations, as was apparent in 2002, would find other channels and ways to pay bribes or illegal payments and evade their external auditors. The SEC was hoping and expecting, by enactment of the act, the external auditors would understand the effect of the accounting provisions, and modify their practice in relation to certifying the adequacy of the internal control systems (Williams 1977). The SEC was confident that it was not necessary to dramatically change the governance and disclosure requirements for corporations (United States 1976). The SEC believed, while the problem was "serious and widespread", it was controllable and did not "represent an inherent defect in ... [the] economic system" (Rubin 1976, p.622). It was hoped that corporations, external auditors' clients, would have sought clarification and understanding of the rules from them. This expectation by the SEC was "considered unworkable by the accounting profession" (Williams 1977, p.60).

#### **4. History Repeating Itself: A New Remedy for an Old Problem**

In 2002, the (Sarbanes-Oxley) SOX act was passed by the Congress and signed after six months of congressional hearings and debate, which was in “response to increasing public concern over corporate malfeasance” as well as a “renewed call for prosecution of U.S. companies engaging in bribery overseas” (Turk 2013, p.347). The response by the Congress to the corporate scandals of the early twenty first century, despite billions in investor losses, was similar to that in reaction to the Watergate scandal in the 1970s. The responses were both “sluggish and timid at best”, since the acts only provided remedies on paper (Bakan 2012, p.8). As claimed by Levitt (2002, p.xvii), the longest serving SEC chairman, Congress had

reverted to its natural state by paying greater heed to the special pleadings of lobbyists for Wall Street firms and corporations than to the interest of individual investors, who have no lobbyists.

The purpose of the SOX act was similar to the FCPA that was signed into law twenty five years earlier. The purpose was to improve the accuracy of accounting and record-keeping of companies.

Both pieces of legislation, namely the FCPA and the SOX act, were rooted in the corporate self-regulatory system of governance and accountability which can be said to have failed “to achieve regular compliance with baseline ethical and legal behaviors as evidenced by a century of repeated corporate debacles” (Weismann 2008, p.615). However, the main difference was that the FCPA mainly focused on self-regulation dominated by industry and reliance on corporations to ensure proper corporate governance systems being in place and accurate financial reports being produced. The

other difference was in relation to the stakeholders' reaction to Congressional efforts in passing legislation.

The SOX act, in comparison to the FCPA, gained immediate support in the Congress, after the news about the massive corporate frauds and significant losses of investment for the shareholders. The act was mainly derived by the publicity among investors, demanding far tighter regulations. For this reason, the SOX act became the centre stage of congressional debates, as there was a need for a swift political response and far-reaching reform to regain the trust and confidence of investors in participating in the capital market. The act contained sections pertaining to accounting, auditing and corporate governance. The purpose of these provisions included enhancing confidence in the integrity of the information in financial reports and the perceived value of the corporation to the shareholders. However, the revelations in the wake of the Watergate scandal that multinational corporations had made illicit payments during the 1970s had little, if any, impact on shareholders. For instance, the study of the effect of corporations' concealment of illicit payments during 1975 by Jacoby, Nehemkis and Eells (1977, p.55) concluded "that investors did not make any significant disposal of their stocks on learning of the overseas political payments by the management of the selected ... companies", since these payment were not considered to be having "adverse reflections on the integrity or competence of the managements of companies in which they have invested". The previous chapters also support this view through analysis of the political framework and lack of immediate reaction by the Congress, governmental agencies and the accounting profession.



Enactment of the SOX act has served as a reminder that instances of fraud, bribery and illicit payments have continued to prevail and highlight the ineffectiveness and lack of enforcement of the FCPA provisions. The story described in this thesis is relevant and timely to remind the reader of the lessons to be learned from the enactment of the FCPA and for today's environment after enactment of recent legislation such as the 'Dodd-Frank Wall Street Reform and the Consumer Protection Act of 2010' as well as the SOX act. The SOX act, as harsher legislation, included sections in relation to improvement of the accuracy of company's record keeping and financial reporting to help remedy the situation. As explained in previous chapters, during the 1970s, the Congress and the accounting profession were not interested in improving the accounting and auditing standards. Chapter three explained the accounting profession's struggle during the 1970s in keeping the Government away from setting accounting and auditing standards, even though studies such as Metcalf had recommended changes to the standard setting process and the role of independent auditors.

The importance of the accounting provisions of the FCPA was enhanced and reinforced by the SOX provisions (Pollack 2003; Vega 2009). Section 1106 of the SOX act also added a substantial degree of transparency of accounting provisions by significantly helping to raise "the stakes for non-compliance with the FCPA" by amending "both civil and criminal securities laws to add provisions relating to disclosures and internal controls" (Conrad 2004; Vega 2009, p.438). The major difference between the internal control requirements of both pieces of legislation is the allocation of responsibility in relation to maintenance of proper internal controls. The FCPA responsibility lies with

the companies in general, while the SOX places responsibility on the officers in charge of corporations.

## **5. Lack of Attention by the Accounting Profession**

Chapters two, four and five have provided historical account and analysis of the U.S. attempt to enact the FCPA that was a piece of legislation expected to be the solution to the problem of bribery and illegal corporations' contributions to political players. This political history represents an instance "where accounting was expected", to exist but was absent (Choudhury 1988, p.549). As stated by Choudhury, "the absence of accounting may tell researchers a lot about the nature of accounting and its existence ... and thereby achieve a deeper understanding of the nature of accounting" (Choudhury 1988, p.550). Moller argues

the FCPA legislation ... has dropped off the list of current hot management topics, replaced by others such as SOx. The FCPA is still very much in force, but today as more of an anticorruption, anti-bribery law. An FCPA-related search on the Web today will yield few if any references to the Act's internal control provisions (2008, p.89).

The events surrounding the enactment of the FCPA, suggest that there was a need to utilise the accounting profession and accounting knowledge, to address the issues with corporate managements' ability to use accounting to conceal the use of corporate funds for illicit payments. The instances of off-books accounts and improper disclosure and record keeping, confirm the importance of the impact of accounting on minimising similar events in the future. However, the FCPA was mainly a non-accounting solution to the problem of illicit payments as the congressional hearings and debates mainly

addressed the anti-bribery section of the legislation. The House of Representative's proposed bills were either missing the accounting related issues or were identical to the Senate accounting provisions, initially taken from the SEC's recommendations. Accounting was not employed at a time when it was obvious and needed the most, even though the issues raised by different congressional hearings were all pointing towards problems with record keeping, governance and external auditors. Absence of accounting in this context contains information that needs to be investigated and explained, which this study has attempted to do.

The SEC focus on corporate accountability, changed its emphasis to corporate governance and advocated practices such as "independent directors and an independent audit committee to exercise oversight over management and the role of the auditor as an independent gatekeeper" (Black 2012, p.1100-1101). The accounting profession on the other hand seemed to be side stepping the issue at hand and leaving it to the SEC. While the SEC wanted only to focus on their mission of corporations' full disclosure of material facts to their investors (United States 1976). Black argued that by enactment of the FCPA, the Congress had given "the SEC power that it did not want, that ... was not part of its central mission", putting a "strain on its resources" (Black 2012, p.1118-1119).

The accounting profession as stated by Carey (1970, p.4)

is the product of an industrial, free-enterprise economy, mainly by private capital, but subject to widespread government regulation. Economic and social change created the *need* for an accounting profession - but accountants themselves *created* the profession ... . Progress at times has seemed slow, and

often it has been painful. CPAs, being human, have rarely embraced change with enthusiasm, or happily abandoned the security of the familiar. Many of their advances, indeed, have been the result of outside pressures.

In relation to the accounting provisions of the FCPA, no formal or direct investigation or study concerning corporate governance and internal affairs, independent auditors' duties in reference to illicit payments was performed by the profession, during this time period. Relating to Carey's statement, not until 1988 and in response to the Treadway Commission recommendations, issuance of any rules or interpretive guidance in relation to corporate accountability was not on the SEC's agenda (Black 2012). These issues "were not fully achieved until after another era of corporate scandals ... that resulted in the enactment of the Sarbanes-Oxley Act of 2002" as briefly explained earlier (Black 2012, p.1101). As explained by Carey

[t]he opportunities available to the profession ... are almost limitless. The key word, however, is "opportunities". To exploit them the profession must improve itself in many ways. An examination of what has happened, and why, and how, may facilitate the determination of what needs to be done (1970, p.13).

The FCPA, was a cautioned response to the immense problem that had surfaced in the 1970s (United States 1977g). It was passed by the Congress "in the context of a heightened focus on ethics in government and in business that was part of the political fallout of the scandal" (Gutterman 2013, p.3). The act's accounting provisions were based on "the self-regulatory model of enforcement: corporate self-policing through mandatory reporting with regulatory oversight" (Weismann 2008, p.615). As noted by Senator Proxmire, Congressman Moss and Senator Metcalf, the self-regulation system itself was at the heart of the problem that required the attention of the SEC and the accounting profession. According to Levitt (2002), it is naïve to think that the self-regulatory system would enable the accountants to work in the best interest of the

investors. The self-regulatory system was weakening the enforcement and application of the accounting provisions of the act. The system was argued to be insufficient to curb bribery and corrupt practices by corporations. Issuing another law was not as important and effective as tailoring the law “to the genuine problem and not to the optical one” (United States 1977d, p.178).

Several affiliates of the accounting profession had opposed the accounting provisions when they were first introduced to the Congress, as being “counterproductive to the audit process” (Chira 1979, p.61). The AICPA objections in their testimonies to the Congress were in relation to the legislation’s accounting provision going “far beyond the problem of illegal corporate payments and establishing a required structure of corporate accountability and by making it illegal to distort proper recordkeeping” (United States 1977d, p.166). During 1976, as detailed in the previous chapters, the AICPA issued exposure drafts in relation to auditors’ responsibilities and duties towards detection of errors and irregularities. However the exposure draft’s focus was on

unintentional mistakes in financial statements ...[,] intentional distortions of financial statements, such as deliberate misrepresentations by management fraud, or misappropriations of assets, ... [and] misrepresentations or omission of the effects of events or transactions; manipulation, falsification, or alteration of records or documents

not enforcing the accounting provisions of the FCPA (Auditing Standards Executive Committee 1976, p.5). Changes to the auditing standards were happening but at glacial pace and seemed as if the AICPA was not getting the message.

## 6. Unnecessary Amendments of the FCPA

Due to the claimed chilling effect of the FCPA on American businesses, during the 1980s, bills pertaining to amendments of the act were introduced to the Congress. The amendments were broadly approved and pushed by the corporations. As argued by Moran (2010, p.219) influences of businesses “over regulation has been strengthened ... by a shift in the priorities of politicians”. Corporations, as pointed out by Bakan (2012, p.5) increasingly “dictate the decisions of their supposed overseers in government and control domains of society once firmly embedded within the public sphere”. Their power over government has increased throughout the years, in a way that has weakened the “government’s ability to control them” (Bakan 2012, p.8). This shift in power has made it possible for the corporations to govern society, even more than the government.

The administration of the time, the Reagan Administration, acknowledged the alleged export disincentives and negative economic effect of the act and wanted to repeal the accounting provisions and the SEC powers entirely, while distancing themselves from appearing to be condoning bribery. Reagan’s election promise was to soften the regulatory initiatives in the 1970s and reduce the burden of regulation on businesses. Deregulation was at the top of the administration’s agenda. The support for repealing the act by the corporations and the administration reflected the manipulation of the political environment of the time. Corporations were united in promoting neoliberal policies (Merino et al. 2010). However, some of the critics as stated by Gutterman argued that the modifications “rendered the FCPA toothless, the changes stopped far short of almost all the amendments that the businesses lobby had promoted” (2013,

p.16). The lobbying effect of the businesses in this instance proved to be ineffective, as the businesses wanted the amendments to weaken or abolish the act.

## **7. Enforcement of the FCPA**

The accounting provisions of the FCPA were left by the Congress and the SEC to be vague and simple. The SEC had refused to issue any guidelines in relation to these provisions as it had left the standard setting authority with the accounting profession. Partly for this reason and the political and economic environment surrounding the enactment and amendment of the act, it was not enforced appropriately. Lack of enforcement allowed corporations to bend the legislation's provisions to their own benefit, which meant that the system itself was corrupt.

As illustrated by Weismann (2009, p.616), the act has not been operating in a “regulatory vacuum” and has been affected by “powerful political, legal, and economic forces”. For instance, during the Reagan administration, funding for the enforcement agencies was “significantly reduced” (Borgman & Datar 2012, p.12; Cragg & Woof 2002) which partly led to relaxing the enforcement of the act and the Department of Justice fraud section having few authorised prosecutors in conducting the FCPA cases (Cragg & Woof 2002). Also, after Williams' chairmanship of the SEC had ended in 1981, the SEC's attention was moved from the FCPA provisions' enforcement to “capital formation issues ... and insider trading” (Black 2012, p.1105). This resulted in an absence of any public speeches or any new rule proposals relating to the act or interpretative guidance (Black 2012).

According to Koehler, the SEC and the DoJ, as the two government agencies responsible for enforcing the statute and, no matter what they would enforce, the end result would be the same, which is “privately negotiated and subjected to little or no judicial scrutiny” (2010, p.924). Porrata-Doria (1985, p.49) also stated that “[m]ost of these ... [cases] appear to have been settled by consent decrees rather than litigation”. For example, between 1997 and 2003, only “an estimated total of sixty cases” were prosecuted by the SEC and the DoJ (Turk 2013, p.341). This was possibly as a result of a “lack of political support for certain prosecutions” (Pines 1994, p.195). Private negotiations and lack of prosecutions would have signalled to the corporations that it is acceptable or part of business necessity to pay bribes with little fear of prosecution which explains the complex economic and political environment that surrounded the FCPA enforcement. However, from the SEC’s point of view, the settlements were used to intimidate businesses into “consciously avoiding the adverse publicity of litigation rather than recognizing the illegality of their activities” (Bagby 1983, p.232). In Koehler’s opinion, “FCPA enforcement actions ... reflect a risk-based decision primarily grounded in issues other than facts or the law” (2010, p.925). Based on these grounds, the persistent criticism by the OECD is

the dividing line between bribe payments and facilitation payments remain somewhat unclear because with the absence of enforcement also comes the absence of a body of case law interpreting the scope of legislative application (Weismann 2009, p.619).

## **8. Concluding Argument of this Study**

As illustrated in this thesis, the history of passing legislation in relation to fraudulent and corrupt practice has demonstrated the economic and political characteristics of the environment that surrounds setting legislation and the failure of the political system as a



whole. This study has explained the events surrounding enactment and enforcement of the FCPA to demonstrate this failure and lack of the capability of the accounting profession and the SEC in combating the corruption and bribery problems. The SEC and the accounting profession heavily relied on the self-regulation system, as the most efficient system, to resolve the illicit payment issue. However, from the arguments presented it can be concluded that the act was and “is a failed regulatory initiative in combating global commercial bribery” and the OECD “has repeatedly questioned its impact in the global business community” although it has been claimed otherwise by the SEC or the DoJ (Weismann 2008, p.615).

The accounting scandals during the 1980s and 2000s exposed systematic failure of the corporate governance and internal control systems that was included in the FCPA. The scandals demonstrated the FCPA failure. The corporate scandals once again highlight the inefficiency and ineffectiveness of the system as a whole. The self-policing system advocated by the SEC and the accounting profession has also proved to be incapable of self-reform. The Congress was in the spotlight again in the 1980s and 2002, and needed to demonstrate it was doing something constructive to put an end to the problems discussed in this thesis.

The Congress initiated hearings that were related to the shortcomings and lack of enforcement of the accounting provisions of the act. The hearings held in the 1980s explicitly, parallel to the hearings held by Church, Proxmire and Metcalf in the 1970s, were related to the adequacy of the self-regulation system and the way accounting and auditing standards were established. In addition, the issues of external auditors’

independence and their responsibility towards shareholders, resurfaced again during the 1980s hearings as well. These issues and concerns were raised during the hearings held in the 1970s and were neglected by the SEC and the accounting profession. The absence of accounting discussion in the Congress, can be seen as the result of the power of the private sector over establishment of accounting and auditing standards and maintaining this authority in-house.

The power which can be said to be fuelled by corporations and corporate executives, helped the accounting profession to defeat any regulatory or public scrutiny. The absence also represents the eagerness of the accounting profession and the SEC to protect and perpetuate the self-regulatory disclosure and accountability system. The effectiveness of the system was promoted and praised by the AICPA and the SEC and was claimed to be producing “the most efficient and effective corporate governance and internal control practices” (Matson & Shapiro 2005, p.5). Self-regulation has served the interests of both the accounting profession and the SEC.

In 2002, in the wake of yet another wave of business, governance and audit failures, the Congress was forced by the public and the press, to pass legislation with intents similar to those of the FCPA. Clearly, the lessons of the 1970s were not learned nor effectively acted upon. The SOX act was enacted in the hope of strengthening the integrity and reputation of U.S. corporations and, to some extent, the accounting profession. The passage of the SOX act also demonstrated that the issues surrounding the role of independent auditors and their duties towards the public had not been resolved.

From the above concluding points and repeated corporate and legislative failures, it is clear that “the current self-regulatory system is broken and oversight of the self-regulatory system by the Securities and Exchange Commission (SEC) has not been effective in addressing these issues to adequately protect the public interest” (General Accounting Office 2002, p.1). To conclude, as was wisely said by Levitt (2002, p.152) “[s]ometimes it takes a crisis to convince the world that the status quo has to change”.

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# Appendix 1: Details of the congressional hearings held from 1972 to 1986

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<b>Name of the hearing</b>	<b>From</b>	<b>To</b>	<b>Chairman of the subcommittee/committee</b>
Presidential Campaign Activities of 1972 hearings before the Select Committee on Presidential Campaign Activities	1972	1974	Sam Ervin
Multinational Corporations and United States Foreign Policy hearings before the Subcommittee on Multinational Corporations of the Committee on Foreign Relations	1973	1976	Frank Church
Lockheed Bribery hearings before the Committee on Banking, Housing and Urban Affairs	1975	1975	William Proxmire
Protecting the ability of the United States to trade abroad hearing before the Subcommittee on International Trade of the Committee on Finance	1975	1975	Abraham Ribicoff
The activities of American Multinational Corporations Abroad hearings before the Subcommittee on International Economic Policy of the Committee on International Relations,	1975	1975	Robert Nix
Oversight Hearings into the Operations of the IRS hearings before a Subcommittee of the Committee on Government Operations	1975	1975	Benjamin Rosenthal
Abuses of Corporate power hearings before the Subcommittee on Priorities and Economy in Government of the Joint Economic Committee	1976	1976	William Proxmire
Corporate Rights and Responsibilities hearings before the Committee on Commerce	1976	1976	Warren Magnuson
Federal Regulation and Regulatory reform Report by the Subcommittee on Oversight and Investigations of the Committee on Interstate and Foreign Commerce	1976	1976	John Moss
Foreign and Corporate Bribes hearings before the Committee on Banking, Housing and Urban Affairs	1976	1976	William Proxmire
Foreign Payments Disclosure hearings before the Subcommittee on Consumer Protection and Finance of the Committee on Interstate and Foreign Commerce	1976	1976	John Murphy

Oversight on the Lockheed Loan Guarantee hearings before the Committee on Banking, Housing and Urban Affairs	1976	1976	William Proxmire
Prohibiting Bribes to Foreign Officials hearing before the Committee on Banking, Housing and Urban Affairs	1976	1976	William Proxmire
SEC Voluntary Compliance Program on Corporate Disclosure Staff Study by the Subcommittee on Oversight and Investigations of the Committee on Interstate and Foreign Commerce	1976	1976	John Moss
Regulatory Reform hearings before the Subcommittee on Oversight and Investigations of the Committee on Interstate and Foreign Commerce	1976	1976	John Moss
Federal Regulation and Regulatory Reform Report by the Subcommittee on Oversight and Investigations of the Committee on Interstate and Foreign Commerce	1976	1976	John Moss
Accounting and Auditing Practices and Procedures hearings before the Subcommittee on Reports, Accounting, and Management of the Committee on Governmental Affairs	1977	1977	Lee Metcalf
Corporate Business Practices and United States foreign policy hearing before the Subcommittee on International Economic Policy and Trade of the Committee on International Relations	1977	1977	Jonathan Bingham
Foreign Corrupt Practices and Domestic and Foreign Investment Disclosure hearing before the Committee on Banking, Housing, and Urban Affairs	1977	1977	William Proxmire
Unlawful Corporate Payments Act of 1977 hearings before the Subcommittee on Consumer Protection and Finance of the Committee on Interstate and Foreign Commerce	1977	1977	Bob Eckhaedt
Foreign Corrupt Practices Act hearing before the Subcommittee on Oversight and Investigations of the Committee on Interstate and Foreign Commerce	1979	1979	Bob Eckhaedt
Foreign Corrupt Practices Act-oversight hearings before the Subcommittee on Telecommunications, Consumer Protection, and Finance of the Committee on Energy and Commerce	1981	1982	Timothy Wirth
The Foreign Trade Practices Act hearings before the Subcommittee on International Economic Policy and Trade of the Committee on Foreign Affairs	1983	1983	Don Bonker
Business Accounting and Foreign Trade Simplification Act joint hearings before the	1983	1986	Alfonse D'Amato

Subcommittee on International Finance and Monetary Policy and the Subcommittee on Securities of the Committee on Banking, Housing, and Urban Affairs			
SEC Corporate Audits hearings before the Subcommittee on Oversight and Investigations and the Committee on Energy and Commerce	1985	1986	John Dingell
Financial reporting practices hearings before the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce, House of Representatives	1987	1988	John Dingell

## Appendix 2: SEC Commissioners and Chairmen

President	Commissioner	Chairman	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
Nixon	William J Casey	×													
	John R Evans														
	G Bradford Cook	×													
	Philip A Loomis														
	Ray Garrett, Jr	×													
	A.A. Sommer, Jr														
Ford	Roderick M Hills	×													
Carter	Harold M William	×													
	Stephen J Friedman														

## Appendix 3: Bills presented to the Senate and House of Representatives

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date		senate		House of Representatives	
		Bill Number	Sponsor	Bill Number	Sponsor
1975	3 June			H.R. 7539	Congressman Stephen Solarz
1976	11 March	S. 3133	Senator William Proxmire		
	5 May	S. 3379	Senators Frank Church		
	12 May	S. 3418	Senator Proxmire at the request of the SEC		
	18 May			H.R. 13870 (Identical to S.3133)	Congressman Moss
	21 May			H.R. 13953 (Version of S.3133)	Congressman Pickle
	11 June			H.R. 14340 (Identical to S.3379)	Congressman Stephen Solarz
	2 July	S. 3664 (combined S.3379 and S. 3418)	Committee on Banking, Housing and Urban	H.R. 14681	Congressman Stephen Solarz
	September	S. 3664 was passed		H.R 15481 (Version of S. 3664)	Mr Murphy
1977	January	S. 305	Senator Proxmire and Williams	H.R 1602	Mr Murphy
	February			H.R 3815	Congressman Eckhardt
	May	S. 305 was passed			
	November			H.R 3815 was passed	
	December	S. 305 (modified version based on H.R 3815)	Senator Proxmire	S. 305 was approved	
1981	March	S. 708	Senator John Chafee	H.R. 2530 (Identical to S. 708)	Congressman Rinaldo
1983	February	S. 414	Senator John Heinz		
	March			H.R 2157	Mr Mica
1985	January	S. 430 (Identical to S. 414)			
1986	March			H.R. 4389	Mr Mica