94th Congress
2d Session

COMMITTEE PRINT

REPORT

OF THE

SECURITIES AND EXCHANGE COMMISSION

ON

QUESTIONABLE AND ILLEGAL CORPORATE PAYMENTS AND PRACTICES

SUBMITTED TO THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

UNITED STATES SENATE

MAY 1976

Printed for the use of the Committee on Banking, Housing and Urban Affairs

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U.S. GOVERNMENT PRINTING OFFICE

71-389 O

WASHINGTON : 1976

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WASHINGTON, D.C. 20510

May 14, 1976

LETTER OF TRANSMITTAL

I am submitting for the use of the Committee the Report of the Securities and Exchange Commission on Questionable and Illegal Corporate Payments and Practices submitted to the Senate Committee on Banking, Housing and Urban Affairs on May 12, 1976.

Sincerely,

William Proxmire
Chairman

REPORT OF THE SECURITIES AND EXCHANGE COMMISSION ON QUESTIONABLE AND ILLEGAL CORPORATE PAYMENTS AND PRACTICES

SUBMITTED TO THE
SENATE BANKING, HOUSING AND URBAN AFFAIRS COMMITTEE
May 12, 1976

INTRODUCTION

In a letter dated March 18, 1976, to Chairman Proxmire, Chairman Hills offered to provide a detailed analysis of information concerning illegal or questionable foreign payments contained in public documents filed with the Securities and Exchange Commission. The following sets forth that report.

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

Accordingly, the primary thrust of our actions has been to restore the efficacy of the system of corporate accountability and to encourage the boards of directors to exercise their authority to deal with the issue.

To this end we have sought independent review of past disclosure in our enforcement actions and in our voluntary disclosure program; we have requested the auditing profession to review its procedures and to make suggestions for dealing with the problem and we have asked the New York Stock Exchange and others to consider helping us strengthen the ability and resolve of the boards of our major corporations to act independently of operating management.

Part I of this report provides a description of the Commission's activities in this area, as well as an analysis of public information that has been disclosed as a result of these activities and of the response of the private sector to the problems we have identified.

Part II contains the Commission's analysis of, and recommendations with respect to, S. 3133, as well as its legislative proposal to deal with the matter of questionable and illegal corporate payments and a description of further actions taken by the Commission to encourage corporate accountability in this area.

In order to restore the integrity of the disclosure system and to make corporate officials more fully accountable to their boards of directors and shareholders, the Commission's basic approach has been twofold:

-- To insure that investors and shareholders receive material facts necessary to make informed investment decisions and to assess the quality of management; and

-- To establish a climate in which corporate management and the professionals that advise them become fully aware of these problems and deal with them in an effective and responsible manner.

The Commission is confident that its legislative proposals and the suggestions contained in Part II of this report will help foster a climate that will rectify many of the problems we have identified.

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PART I: THE COMMISSION'S ACTIVITIES AND CONCLUSIONS

A synopsis of the public filings made with the Commission has been assembled in tabular form, attached as Exhibit A. The Commission's staff, in preparing these tables, has analyzed the public disclosures filed with it by 89 corporations as of April 21, 1976, that refer to questionable or illegal foreign and domestic payments and practices. In addition, the staff has prepared summaries of the six special reports obtained as a result of our enforcement actions, attached as Exhibit B. Finally, we also have included as part of Exhibit B a description of the allegations made in eight other enforcement actions in which we have obtained judicial relief but where reports have not been completed or, in one instance, will not be required.

The tremendous variation in the types and amounts of payments and the attendant circumstances disclosed in the reports filed with the Commission make categorization or quantification of the extent and seriousness of the problem of questionable or illegal foreign payments difficult. Accordingly, we recognize that the matters reported in these exhibits may lead others to conclusions

concerning the nature, extent and seriousness of the problem that differ from our own. The Commission, therefore, is providing the Committee a copy of each of the underlying public documents on which our analysis is based so that Committee can reach its own determinations, where appropriate.

A. Sources of Information: The Commission's Disclosure and Enforcement Programs

Before considering the extent of the problem of questionable or illegal foreign payments, it would be helpful to describe the nature of the disclosure system and the enforcement efforts that produced the information set forth in the Exhibits.

1. Enforcement Program

In 1973, as a result of the work of the Office of the Special Prosecutor, several corporations and executive officers were charged with using corporate funds for illegal domestic political contributions. The Commission recognized that these activities involved matters of possible significance to public investors, the nondisclosure of which might entail violations of the federal securities laws. On March 8, 1974, the Commission therefore published a statement

expressing the view of its Division of Corporation Finance concerning disclosure of these matters in public filings. 1/

The Commission's inquiry into the circumstances surrounding alleged illegal political campaign contributions revealed that violations of the federal securities laws had indeed occurred. The staff discovered falsifications of corporate financial records, designed to disguise or conceal the source and application of corporate funds misused for illegal purposes, as well as the existence of secret "slush funds" disbursed outside the normal financial accountability system. These secret funds were used for a number of purposes, including in some instances, questionable or illegal foreign payments. These practices cast doubt on the integrity and reliability of the corporate books and records which are the very foundation of the disclosure system established by the federal securities laws.

The resulting investigations culminated in the institution of injunctive actions against nine corporations during the one-year period following the Spring of 1974. Subsequently other cases were brought involving questionable or illegal foreign and domestic payments and practices. Details of the facts alleged and ultimately established in these enforcement actions are contained in Exhibit B.

1/ Securities Act Release No. 5466 (Mar. 8, 1974).

In each of the fourteen cases filed as of May 10, 1976, the corporate defendants have, without admitting or denying the allegations of the complaint, consented to the entry of a judgment of permanent injunction prohibiting future violations of the federal securities laws.[2/] In thirteen of these cases, the consent decree required the company to establish a special review committee, composed of independent members of its board of directors, and to conduct a full investigation of the irregularities alleged in the Commission's complaint. These committees generally have utilized independent accountants and legal counsel to conduct a thorough examination of, among other things, the corporation's books and records.

The special committees must submit complete reports of their investigations to the board of directors, which, in turn, is responsible for reviewing and implementing the recommendations they contain. Recommendations submitted by these special committees have dealt with such matters as claims for reimbursement, legal or disciplinary actions against

2/ See Exhibit B. One case, Securities and Exchange Commission v. Kalvex, Inc., CCH Fed. Sec. L. Rptr. ¶95,226 (July 7, 1975), was litigated with respect to some of the individual defendants. The Commission cannot, for course, comment on actions presently pending, nor can we discuss the facts that have been uncovered in the approximately 25 formal, private Commission investigations that have not yet resulted in public enforcement actions.

individual members of management, matters of corporate structure and policy designed to prevent recurrence, and related subjects. Restitution has been made to the corporation in some cases. To date, six reports have been filed.[3/]

Our enforcement activities are continuing. On May 10, 1976, the Commission commenced an enforcement action against the General Tire and Rubber Company for alleged violations of the federal securities laws arising out of the nondisclosure of certain corporate practices. The Commission alleged, among other things, that, under the direction of its President, the company diverted corporate funds for political purposes by by means of purported bonuses and salary increases. The Commission also charged the existence of various "slush funds," including one fund created with the knowledge and approval of the senior management of the company's international division and administered by the managerial director of one affiliate, whose activities in connection with the fund were generally known to senior management. This fund was alleged to total as much as $3.9 million and was used, in part, for payments to foreign government officials. The Commission also

3/ The reports are required to be filed with the court as part of the record in the action and with the Commission as an exhibit to the company's Current Report on Form 8-K. The reports generally provide a detailed and graphic account of the matters examined by the committees. The Commission reserves the right to apply to the court for further relief if not satisfied with the report.

charged that another such fund, maintained by a foreign subsidiary, was used to make payments, made in connection with payments by five other major tire companies, to finance an effort to obtain approval from a foreign government of a proposed price increase. The Commission also alleged that an aggregate of $800,000 was promised a foreign consultant for his assistance in obtaining favorable foreign government action with the understanding that a portion of that sum would be transferred to foreign government officials. Without admitting or denying the allegations in the Commission's complaint, the company consented to the entry of a permanent order of injunction against future violations of the federal securities laws. Moreover, it consented to the establishment of a special committee, similar to those previously described, to conduct a thorough inquiry and report to the court, the Commission, and the shareholders, and to certain other relief.

2. The Voluntary Disclosure Program

As the Commission's enforcement efforts unfolded, it became apparent that the potential magnitude of the problems required an additional disclosure mechanism to supplement

4/ The Commission also alleged that the company made a $150,000 foreign payment in order to have itself removed from the Arab Boycott list, and in connection with that effort sworn certificates were filed with the Arab League representing that General Tire and its subsidiaries did not, and would not provide technical assistance or know-how to any Israeli company and that a particular major General Tire subsidiary would not provide technical assistance or make any investment in Israel.

the enforcement actions undertaken, and that the most appropriate means was to encourage voluntary corporate disclosure of questionable or illegal foreign payments. It therefore was suggested in public statements, including the testimony of Commissioner Loomis before the Subcommittee on International Economic Policy of the House of Representatives Committee on International Relations, that companies determining they might have engaged in such activities should conduct a careful investigation of the facts under the auspices of persons not involved in the questionable activities. If the investigation disclosed a problem, the company was encouraged to discuss the question of appropriate disclosure of these matters with the Commission's staff before filing any documents.5/

The sometimes unique problems involved in the disclosure of questionable or illegal foreign payments, however, and the resultant uncertainties concerning the nature and scope of required disclosures prompted the

5/ Discussions of this nature are contemplated by Rules 1(d) and 2 of the Commission's Informal and Other Procedures, 17 CFR 202.1(d) and 202.2, pursuant to which the staff of the Commission's Division of Corporation Finance renders prefiling assistance and interpretative advice. Similarly, the staff of that Division routinely reviews the filings the Commission receives pursuant to the requirements of the federal securities laws, and, when deficiencies are apparent on the face thereof, may either contact the registrant and seek to have the appropriate corrections made or may refer the matter to the Division of Enforcement. See Rule 3(a) of the Commission's Informal and Other Procedures, 17 CFR 202.3(a); Securities Act Release No. 4936 (Dec. 9, 1968).

Commission to develop special procedures for registrants seeking guidance as to the proper disclosure of these matters. These procedures, frequently referred to as the "voluntary disclosure program," have been described in some detail in Chairman Hills' testimony before the Subcommittee on Priorities and Economy in Government on January 14, 1976. 6/

In broad terms, the program requires that a company determining that it may have a disclosure problem with respect to questionable or illegal activities, including the improper recording or accounting of such activities, promptly take the following steps: 7/

1. Authorize a careful in-depth investigation of the facts relating to questionable or illegal foreign or domestic activities by persons not involved in the activities in question. If practicable, such persons should report and be responsible to a committee comprised

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6/ Although the voluntary disclosure program was originally conceived to apply only to foreign payment problems, in practice it has been applied to disclosures of certain domestic problems as well. In addition to requiring appropriate disclosure under the federal securities laws, the Commission refers matters that appear to represent violations of domestic law to the appropriate law enforcement authorities.

7/ Although participation in the voluntary program does not insulate a company from Commission enforcement action, it does diminish the possibility that the Commission will, in its discretion, institute an action.

of members of the board of directors who are not officers of the company and who were not involved in the suspected questionable or illegal practices

Generally, assistance should be sought from the independent accounting firm that regularly audits the corporation unless the circumstances suggest otherwise. The committee also should consider retaining outside counsel. The investigation should encompass the prior five years, the period covered by the financial statements required in annual reports and registration statements filed pursuant to the federal securities laws, but also should examine any events occurring prior to that time that may appear to be part of a continuing program or to be related to existing material contracts or business operations. At the conclusion of the investigation, the committee should prepare and submit to the full board of directors a report setting forth its findings. The report should, to the extent possible, contain detailed information about each payment; its purpose and amount; the recipient; the country in which the payment was made and the circumstances in which payment occurred. 8/

2. The board of directors should issue an appropriate policy statement with respect to transactions involving illegal or questionable activities in the United

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8/ An essential element of the voluntary disclosure program is that companies must agree to grant the Division of Enforcement access to the report and its underlying documentation.

Materials submitted to the Commission may be subject to release under the Freedom of Information Act or pursuant to Congressional requests. Specific claims of exemption from the Freedom of Information Act must be founded upon the provisions of that Act.

States or abroad, or reiterate any relevant, pre-existing policy statement. Normally, this statement should include a declaration of cessation of such activities, if any, and a prohibition against the maintenance of improper books and records and inadequate supporting documentation relating to such activities. The adoption of such a policy should be communicated to appropriate corporate personnel, implemented by adequate internal controls and safeguards, and monitored by auditing programs established by the independent auditors.

3. The corporation should consider whether interim public disclosure of the results should be made prior to completion of the investigation. This disclosure generally is made on a Form 8-K filed with the Commission, supplemented in some cases by the issuance of a press release.

4. At the conclusion of the investigation, a final report of material facts must be filed with the Commission, generally on on Form 8-K.

Depending on the timing of the disclosure and the status of the investigation, a corporation's disclosure in a current or annual report, registration statement or other filing generally should include the following:

1. The nature, scope and progress of the corporation's investigation, including an identification of the persons conducting it and the persons to whom they are responsible;

2. The company's undertaking regarding continuation or termination of the practices in question, and its policy with respect to assuring the integrity of its books and records and establishing adequate internal controls and procedures;

3. The corporation's undertaking to complete the study and submit a final report;

4. The corporation's undertaking to provide access to the Commission's staff to information and documents developed during the investigation; and

5. Material information developed regarding illegal or questionable transactions that occurred during the last five years. This frequently would include their purpose; the amounts involved; the extent of possible knowledge, approval or authorization of the transactions by top management; details of any defalcations by corporate officials or personal benefits accruing to them; the accounting treatment accorded to the transactions, including whether false, fictitious or misleading entries were made to record such transactions; the existence of any unreconciled funds, "slush funds," unrecorded bank accounts or similar "off book" accounts; the possible foreign and domestic tax consequences, if any, of the reported activities; and the amount of business related to such payments and the possible effect of their cessation on consolidated income, revenues and assets or business operations of the company; as well as any other information that may be required on a case-by-case basis.

Companies in the voluntary disclosure program can make disclosures without prior consultation with the Commission's staff and without jeopardizing their participation in the program. They can, however, seek the informal views of the Commission itself concerning the appropriate disclosure of certain matters.[9/] And the staff has, in its

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9/ Rule 1(d) of the Commission's Informal and Other Procedures, supra note 5, provides that the staff, on request or on its own initiative, may present questions to the Commission for its informal views. The Commission's decision to grant a request for informal views is, however, completely discretionary.

discretion, brought particular disclosure questions to the Commission to obtain its views and communicate them to the companies involved.

Although this report and prior testimony have described the voluntary disclosure program in some detail, and it frequently has received congressional and public attention, it is important to note that there is no requirement that a company's disclosures concerning questionable payments be made within the framework of the program. Many registrants have simply made what they consider to be appropriate disclosures without consulting with the Commission's staff.[10/] The nature and detail of these disclosures reflect those companies' own independent judgments as to what is material, or what otherwise should be disclosed to investors and shareholders as a matter of good corporate relations.[11/] Moreover, a substantial number of the participants in the program have made disclosures after consultations with the staff, but without seeking the

10/ These disclosures still are subject to review and comment by the staff of the Division of Corporation Finance in appropriate cases, as well as to inquiry and action by the Division of Enforcement, if necessary.

11/ Many of the companies that have made public disclosure of these matters in public filings have included an explicit statement that disclosure should not be deemed an admission by the company of the materiality of the facts contained therein.

informal views of the Commission. To date, fewer than twenty companies -- either by company or staff-initiated requests -- have obtained the Commission's informal views regarding the appropriate disclosures called for by the facts presented.[12/]

B. COMMISSION PRACTICES WITH RESPECT TO DISCLOSURE OF QUESTIONABLE PAYMENTS

To date, the informal views expressed by the Commission staff and action taken by the Commission itself have been significantly influenced by the fact that virtually all questionable payment matters have involved the deliberate falsification of corporate books or records, or the maintenance of inaccurate or inadequate books and records which, among other things, prevented these practices from coming to the attention of the company's auditors, outside directors and shareholders. The existence of inaccurate records has, in our judgment, often provided an independent basis for requiring some form of disclosure or the initiation of Commission enforcement action, regardless of whether the payments themselves were of material size or a material amount of business depended on their continuation.

12/ The companies that made public disclosure of questionable or illegal payments after obtaining the Commission's informal views are identified by a double asterisk(**) in Exhibit A. Three others determined not to make public disclosure and thus are not included in Exhibit A.

One consequence of the enforcement cases has been a full accounting, usually undertaken by an independent committee of the board of directors assisted by independent counsel and the company's outside auditors. In other instances, arising under the voluntary disclosure program or made on a voluntary basis, disclosures of a greater or lesser degree have been made, depending on the circumstances of a particular case and the position of management and their professional advisers regarding disclosure of matters they deemed important to the company's shareholders.

These Commission and staff actions, complemented by the increased efforts of the accounting profession to discover these practices and bring them to the attention of management and the board, suggest that in the future there will be far fewer instances in which questionable or illegal payments will be improperly recorded and made without the knowledge of the auditors or board of directors. Moreover, it should be recognized that, since there have been so few instances to date where the corporate records have been properly kept and the questionable payments known to both the company's auditors and directors, past determinations by the Commission and its staff may not reflect what will be required in the future under different circumstances.

Quite apart from these considerations, however, the Commission has been of the view that questionable or illegal

payments that are significant in amount or that, although not significant in amount, relate to a significant amount of business, are material and required to be disclosed.

The Commission is also of the view that questionable or illegal payments, if unknown to the board of directors, could be grounds for disclosure regardless of the size of the payment itself or its impact on dependent business because the fact that corporate officials have been willing to make repeated illegal payments without board knowledge and without proper accounting raises questions regarding improper exercise of corporate authority and may also be a circumstance relevant to the "quality of management" that should be disclosed to the shareholders. Moreover, even if expressly approved by the board of directors, a questionable or illegal payment could cause repercussions of an unknown nature which might extend far beyond the question of the significance either of the payment itself or the business directly dependent upon it. For example, public knowledge that a company is making such illegal payments, even of a minor nature, in one foreign country could cause not only expropriation of assets in that country but also a similar reaction or a discontinuation of material amounts of business in other countries as well. 13/

13/ This occurred in the case of one major oil company, whose payments in one country were asserted as a basis for expropriation of properties in another.

In a sense, therefore, a corporation that decides to make questionable or illegal payments for reasons its board considers to be good and sufficient necessarily must proceed at its own peril.[14/] The Commission may often not be able to give comforting advice to issuers that wish not to make even generic disclosure of the existence of questionable or illegal corporate payments.[15/] The Commission will, of course, continue to make its position known and take appropriate action when it believes the federal securities laws require disclosure of certain facts.

In situations that have come to the Commission's attention, we have proceeded carefully to examine the full facts and circumstances presented by any given case. In so proceeding, we obviously must consider a variety of

14/ Management determinations in this area are further affected by the disclosure policies of some companies that have decided, for reasons of good shareholder relations, to make full disclosure of foreign payments, whether or not legal or material.

15/ That does not mean that the Commission necessarily would object to a filing that does not disclose a small questionable payment revealed to our staff. Rather, we would refuse to provide any comments in such a case.

factors, including the accounting treatment accorded the payments in question; the amount of the payment and its legality under local law; the recipient of the payment and the purpose for which it was made; the knowledge or participation by senior management; the frequency and pervasiveness of the payment practices; and whether the company has taken measures to terminate the activities. Only after this consideration has the Commission been able to come to an informed view as to whether some disclosure of certain matters was required.

The discussion that follows should provide corporate managers and their professional advisors some guidance as to the manner in which they might analyze the many factors that might be presented in cases of this kind.

1. Disclosure Not Otherwise Required By A Specific Statute Rule or Regulation Are Defined By Reference to the Doctrine of Materiality.

The Commission has broad discretion to require specific or generic disclosures of particular kinds of facts. The basic canon of the disclosure system is found in Schedule A of the

Securities Act of 1933, which specifies the items of information to be supplied in registration statements for public offerings and grants the Commission broad discretion to vary these requirements or to add or subtract items.[16/]

In adopting Schedule A, Congress directed the disclosure requirements toward what it viewed as a reasonable investor, whose needs and desires for information were basic and included information relating to the financial and operating condition of the company and the quality of management; conflicts of interest; balance sheets and earnings statements, capital structure; rights of security holders, especially of securities being offered; competition in the industry; significant customers; the backlog of orders; concessions held; lines of business; classes of products or services; the interests of management in certain transactions; certain corporate loans to management, etc. Implicit in such disclosure requirements is the assumption that corporations conduct their business and sell their products on the basis of quality and price rather than bribes or kickbacks. Such

16/ The views expressed herein relate solely to circumstances and practices impacting upon disclosures in proxy materials and registration statements filed with the Commission under the Securities Act of 1933, and in annual and other periodic reports required to be filed under the Securities Exchange Act of 1934.

practices not only bear upon the quality of a registrant's business and the attendant risks, but also on the quality of a registrant's earnings.

In refining and adding to the items specifically required in Securities Act filings in order to meet changing needs and standards, the Commission has adhered to the spirit of Schedule A. The philosophical approach underlying Schedule A also has prevailed in the Commission's development of the continuous reporting system based upon the Securities Exchange Act of 1934.[17/] Public documents filed pursuant to these requirements are the primary source of information concerning questionable or illegal corporate payments.

The disclosure system is oriented toward the basic interests of investors, but it does not speak exclusively to financial relationships and data. Disclosure requirements

17/ In addition to the various specific instructions and requirements incident to each of these filings, the Commission has promulgated rules generally requiring disclosure of all material information concerning registered companies and of all information necessary to prevent other disclosures made from being misleading. See Rules 405(1), 17 CFR 230.405(1) and 408, 17 CFR 230.408 (pertaining to registration statements under the Securities Act of 1933); Rule 12b-20, 17 CFR 240.12b-20 (pertaining to registration statements and annual and periodic reports under the Securities Exchange Act of 1934); and Rules 10b-5, and 14a-9, 17 CFR 240.10b-5, and 240.14a-9.

also should facilitate an evaluation of management's stewardship over corporate assets. In this context, investors should be vitally interested in the quality and integrity of management. A number of factors -- including the background of a director-nominee, changes in management, conflicts of interest, the identity of promoters, interlocking directors and officers, special benefits to management and certain stockholders, and management's outside interests -- are relevant to these concerns. Disclosure of these matters reflects the deeply held belief that the managements of corporations are stewards acting on behalf of the shareholders, who are entitled to honest use of, and accounting for, the funds entrusted to the corporation and to procedures necessary to assure accountability and disclosure of the manner in which management performs its stewardship.[18/]

18/ The Commission considered these issues, although in a somewhat different context, In the Matter of Franchard Corporation, 42 S.E.C. 163, 170 (1964):

> "Evaluation of the quality of management -- to whatever extent it is possible -- is an essential ingredient of informed investment decision. A need so important it cannot be ignored, and in a variety of ways the disclosure requirements of the Securities Act furnish factual information to fill this need. Appraisals of competency begin with information concerning management's past business experience, which is elicited by requirements that a prospectus state the offices and positions held with the issuer by each executive officer within the last 5 years. . . .

(Continued)

In determining whether to require specific disclosures, the Commission generally has weighed the benefits of such disclosure against its assessment of the extent of investor interest and the cost and utility of the particular disclosure.[19/] Except for certain detailed affirmative statutory requirements, information must be furnished only if material.[20/] And, while

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18/ (Footnote continued)

> To permit judgments whether the corporation's affairs are likely to be conducted in the interest of public shareholders, the registration requirements elicit information as to the interests of insiders which may conflict with their duty of loyalty to the corporation. Disclosures are also required with respect to the remuneration and other benefits paid or proposed to be paid to management as well as material transactions between the corporation and its officers, directors, holders of more than 10 percent of its stock, and their associates." (footnotes omitted)

19/ The matters the Commission frequently faces in the area of questionable or illegal payments often are so fundamental to the corporate structure and the integrity of management as to be distinct from other types of corporate activity.

20/ The Supreme Court in Affiliated Ute Citizens v. United States, 406 U.S. 128, 150-151 (1972), adopted a standard of materiality couched in terms of the likely interest in the matter by investors, specifically defined by the Second Circuit Court of Appeals to include not only the long-term investor, but the Wall Street speculator as well. Securities and Exchange Commission v. Texas Gulf Sulphur, 401 F.2d 833, 849(C.A.2 1968), cert. denied, 394 U.S. 976 (1969). Rule 405(1) of the Securities Act of 1933 defines materiality as encompassing all "those matters as to which an average prudent investor ought reasonably to be informed before purchasing securities." 17 CFR. 230.405(1).

the Commission has by regulation established general guidelines on specific problems of materiality, particularly as to financial information, there is no comprehensive regulatory guide with respect to the narrative disclosures.

In attempting to determine whether a specific fact is material there is no litmus paper test. Each case normally presents unique combinations of facts, and the consideration whether particular information should be disclosed necessarily depends on the context in which the question arises. In this regard, however, the falsification of corporate books and records and the accumulation of funds outside the system of corporate accountability -- problems presented in most instances of questionable or illegal activity considered by the Commission to date -- is of paramount concern to investors and cannot be ignored.

In an attempt to provide some guidance for corporations faced with disclosure issues of this kind, the Commission has identified various factors that have given rise to disclosable events in the past. In actual practice, however, it must be recognized that these factors cannot be viewed in isolation. Thus, for example, the Commission's comments concerning the recipients of corporate payments must be read in conjunction with the discussion relating to the knowledge or participation

of corporate management, defects in the system of corporate accountability and the impact on the business of the corporation.

In the final analysis, the disclosure obligation may depend on combinations of these factors. Thus, the views expressed herein cannot relieve corporate management of the obligation to evaluate the specific circumstances of any particular disclosure question.

2. Payments Outside the Financial Accountability System

An essential component of the disclosure system has been the development of accurate, complete, and reliable financial information, a process characterized by the development of increasingly sophisticated accounting principles and auditing and disclosure standards. Basic to the system is the principle that all funds belonging to the corporation, and thus to its shareholders, are adequately maintained within the corporation's system of financial accountability.

One of the most troublesome and pervasive circumstances associated with the cases brought to the Commission's attention has been the treatment of questionable or illegal payments on the company's books and records. The accumulation of funds outside the normal channels of financial accountability, placed

at the discretion of one or a very small number of corporate executives not required to account for expenditures from the fund; the use of non-functional subsidiaries and secret bank accounts; and the laundering of funds or other methods of disguising their source or disbursement quite often have been observed. These situations generally call for disclosure of the existence of the fund or funds, the general method of funding such accounts, their purposes, and the amount of business involved. The need for such disclosures is further accentuated if senior management condoned or approved a pattern of falsification of books and records, thereby casting doubt upon the whole system of accounting and the integrity of the company's financial statements.

3. Legality of the Payment Under Local Law

The legality of the corporate payment has been a particularly important factor. Where the payment violates United States laws, the Commission has adhered to policies governing the need for disclosure of violations of United States laws in other contexts.[21/]

21/ The Commission also refers potential violations of United States laws to the responsible law enforcement agencies.

If the payment is illegal under the local law of a foreign state--a fact which may not always be readily ascertainable--disclosure may be required. Disclosure generally would not be required of payments which are legal under domestic as well as foreign law and are otherwise a proper corporate payment accurately accounted for, unless called for by other generally applicable disclosure concepts.

4. Recipients of the Payments

The nature of the recipient often has been an important factor in determining that a corporate payment was a disclosable event. Various classes of recipients have presented these considerations, including but not limited to government officials, commission agents and consultants of the paying company, and recipients of commercial bribery.

Government Officials: Typically, a corporation would not, in the ordinary course of business, make payments to government officials in their individual capacities. Such payments, therefore, are usually a form of bribery that, where material, would give rise to a disclosable event.

The Commission has observed payments to government officials for four principal purposes. First, corporate payments have been made in an effort to procure special and unjustified favors or advantages in the enactment or

administration of the tax or other laws of the country in question. The disclosure of payments for these purposes has been required where the amounts involved or the corporate benefits obtained have been significant and the payment is made to influence the exercise of judgment and discretion in disposing of matters on behalf of the government.

Second, corporate payments may be made with the intent to assist the company in obtaining or retaining government contracts. It may be possible to distinguish payments intended to secure the favorable exercise of judgment or discretion on behalf of the governmental body from situations where the official, under applicable laws, regulations or customs, appears to have been permitted to act for suppliers in connection with government contracts and to be paid for such services. Where this is permitted, payments to governmental officials so employed may nevertheless be material where other factors, such as the recipient's insistence on the maintenance of secrecy or the inaccurate reflection of the payments on corporate books and records, suggest that the payment is in fact a form of bribery.

A third purpose for payments is to persuade low-level governmental officials to perform functions or services which

they are obliged to perform as part of their governmental responsibilities, but which they may refuse or delay unless compensated. These so-called facilitating payments have been deemed to be material where the payments to particular persons are large in amount or the aggregate amounts are large, or where corporate management has taken steps to conceal them through false entries in corporate books and records.

Another type of payment is the political contribution. Where these contributions are illegal under local law, they can be assimilated to bribery. Even where legal under local law, such payments may be material if the expenditures are such that they appear to be designed to unduly influence public policy decisions.

Commercial Agents and Consultants: The Commission recognizes that corporations doing business abroad often engage the services of non-official nationals possessing specialized information with regard to business opportunities or relationships which are of assistance in securing or maintaining business. There is nothing inherent in this practice that gives rise to a disclosure obligation under the federal securities laws. Certain factors may, however, suggest that payments to such persons should be disclosed.

A variety of considerations, some legitimate and some questionable, may prompt the use of agents or consultants. Among the key factors to be considered in determining whether disclosure may be required is the relationship of the agent to the governmental entity or contracting party, the size and nature of the payment, the services to be performed by the agent, and the method and manner of payment.

The disclosure obligation cannot be avoided because of corporate management's indifference to the question whether the agents are acting as conduits for improper payments. Management must take reasonable steps to determine whether commissions and fees paid are to be transmitted, in whole or in part, to governmental officials or their designees. Commission or consultant payments substantially in excess of the going rate for such services may give rise to a disclosable event, depending upon the significance of the business involved. In many instances, this may suggest that a portion of the commission was, in fact, intended to be passed through to government officials or their designees to influence government action. Similarly, other circumstances that give companies reason to believe that portions of commission payments will be passed on to government officials or their designees present the same problems as those discussed above.

Commercial Bribery: The Commission also has observed payments made to improperly influence a non-governmental customer's use of a company's product or services. These payments may also give rise to a disclosable event.

5. Amount of the Payment

As a general rule, a corporation need not disclose routine expenditures made in the ordinary course of business unless specific disclosure provisions otherwise so require. However, questionable or illegal payments must be disclosed where they are significant in amount or where, even though not significant in terms of absolute amount, are related to a significant amount of business or other relevant financial indicia.[22/]

Under most circumstances, the amount of the payment is not dispositive of the materiality issue unless, of course, the payment is significant by itself. Where the size of the payment does not otherwise require disclosure, the materiality of such payments would depend on the relative economic implications of the payment to the company as a whole or to a significant line of the company's business. Thus, for example, a questionable or illegal payment that seems

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22/ As previously indicated, the methods used to make or facilitate these payments are important factors to be considered. The facilitation of such payments through falsification of corporate records will give rise to a disclosure obligation even in cases where disclosure might otherwise not be required.

relatively small in relation to corporate revenues, income or assets may assume much greater importance when one asseses the amount of business that may be dependent on or affected by it. This in turn may be affected by whether foreign business as a whole, or in a particular country, is significant to the overall business of the company.

6. Knowledge or Participation by Senior Management

Investors have a right under the federal securities laws to be fully advised of facts concerning character and integrity of the officials relevant to their management of the corporation. This is particularly true when management administers significant assets in foreign states, where investors may not have the same protections as exist in the United States. Accordingly, transactions that would not otherwise be material may become so by virtue of the role played by management.

Whether disclosure is required on the basis that it relates to the integrity of management is subject to a number of variations. In situations involving a pervasive pattern of encouragement, participation in or knowledge of these practices by senior management, the need for disclosure is clear. If, on the other hand, senior management neither knew nor should have known of the payments, disclosure may not be required, unless they are otherwise material.

Defalcations and misappropriations by corporate officials bear directly on the integrity of management and the adequacy of its stewardship and should be disclosed. Of course, any indictment of the company or any of its principals arising out of questionable corporate payments may give rise to a separately disclosable event.[23/]

7. Patterns of Payments That Are an Integral Part of Operating a Business or a Significant Segment of the Business

The fact that a company has engaged in a pattern of payments over an extended period of time--which payments when taken individually may not require disclosure--suggest that the company's product or service could not be successfully marketed in the absence of the payments involved, and that failure to continue to make such payments could endanger the business operations. If other companies in the same line of business are not making, or would not make, such payments, a question arises regarding the saleability of the company's product or services.

Where such a pattern of conduct exists with respect to a significant line of business, or conversely, if termination of the payments might be expected to change significantly the economic success of a significant line of business, disclosure is appropriate.

23/ See Securities Act Release No. 5466 (Mar. 8, 1974).

8. Cessation of the Questionable Conduct

A company's strong and adequate measures to assure cessation of its questionable conduct is a significant factor. The Commission must, of course, consider each case on its particular facts. Where such measures have been taken, the Commission, particularly in its voluntary program, has given weight to this fact in assessing the need for disclosure.

C. NATURE AND DETAIL OF DISCLOSURE

Except in egregious cases, the Commission has generally not objected to so-called "generic" disclosure of the circumstances and practices that have come to its attention under the voluntary program, particularly in those instances where the company has represented that it has ceased its questionable or illegal activities. Generally speaking, however, the more serious the problem (and particularly where the company intends to continue such activities), the greater the detail which should be disclosed.

Generic disclosure has included:

1. The existence, amount of, duration, and the purpose for, the foreign payments;

2. The role of management in such payments;

3. The tax consequences, if any, of the payments made;

4. Information about the line of business, or class of product or services in connection with which the payments have been made;

5. The company's intention with respect to the continuation or termination of the practices;

6. The impact that cessation of the payments referred to in items 1 through 4, above, may have on the corporation's consolidated revenues, net income or assets; and

6. The method of effecting payments, including possible falsifications or inadequacies of corporate books and records.

In cases arising under the voluntary program, the Commission generally has not required disclosure of the identity of recipients. On the other hand, the disclosure of the identity of senior management officials who have misappropriated corporate funds or actively encouraged and participated in the falsification of corporate books and records may be required to allow shareholders to critically assess the integrity of management.

With respect to the form of disclosure of such conduct, where it is determined that some disclosure is required, the Form 8-K is normally the appropriate vehicle unless there is an Annual Report on Form 10-K being filed at the time when the problem is being dealt with. Subsequent disclosure in registration statements will depend upon the

timing and other factors. If there is a pending registration statement and the information has not otherwise been disclosed, presumably the disclosure would either be made in the registration statement or in a Form 8-K with a cross-reference to that report in the registration statement.

Disclosure of material facts pertaining to the conduct of persons standing for election has depended on the circumstances of the given case. Where such facts have been previously disclosed in a document generally circulated to shareholders, the Commission has generally not required further disclosure.[24/] When the disclosure is in a public filing not circulated to shareholders, disclosure in the proxy statement may be required depending upon the nature of the conduct involved and management's knowledge of or participation in that conduct, the nature of the issues to be decided in the shareholders' meeting (including who the candidates for board elections may be), and the company's intention with respect to termination of the practices. In some instances, the Commission has determined that a meaningful cross-reference to a previous filing would be sufficient.

D. ANALYSIS OF INFORMATION DISCLOSED

1. Tabular Presentation of Disclosure Results.

The table attached as Exhibit A presents a general portrayal of the public disclosures received as of April 21,

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24/ Disclosure may be required when the conduct is particularly relevant to the "quality of management" standing for election; where the earlier circulated document was not proximate in time to the proxy mailing; and where management has not disclosed its intention to stop the practices.

1976, concerning questionable or illegal foreign or domestic corporate practices. The conduct reported varies significantly, and the companies included can by no means universally be characterized as wrongdoers. Instead, they range from companies that have filed reports reiterating previously-expressed corporate policies opposing illegal or questionable practices; to those indicating they are conducting investigations; to those that report serious and pervasive patterns of questionable and illegal conduct.

In compiling Exhibit A, the staff consulted only publicly filed documents. In cases in which these documents appeared to suggest a category of conduct, an entry was made in the chart. Where no statement on an issue was made, however, the chart simply shows "not indicated."

In general, Exhibit A reflects the matters disclosed in the public filings in as close to the corporation's own terms as is possible, given the format of the Exhibit. The staff has not relied on or included information that is not contained in the public filings and has likewise sought to avoid making substantive judgments as to the matters disclosed.[25/]

25/ Inclusion of facts in these charts should not be construed as a Commission affirmation of their truth or accuracy. Many of the companies included in Exhibit A currently are under investigation by the Division of Enforcement. These investigations should allow the Commission to test the accuracy and adequacy of these disclosures under the federal securities laws.

To the extent possible, we have attempted to divide the disclosures contained in the filings into broad categories that provide a very general indication of the activities described by the reporting companies. Disclosures made by the corporations vary significantly, both as to substance and detail, and often do not lend themselves to easy classification. Frequently, for example, the documents do not clearly indicate whether or to what extent foreign "commission-type payments" are made directly to employees or officials of foreign governments. Thus, the distinction between this category and "payments to foreign officials" is sometimes not as clear as the tabular presentation would suggest.

Finally, it should be emphasized that an analysis of the information in Exhibit A must be undertaken with great caution. Although the Commission is confident that both the tables and the following narrative discussion present a reasonably accurate general description of the matters disclosed in these filings, any evaluation of the conduct of a particular corporation based on the information set forth in Exhibit A inevitably suffers the infirmities inherent in attempting to compress a significant amount of information into a limited format. The Commission

therefore strongly suggests that the assessment of the activities of any particular corporation rest on the actual filings themselves rather than on the distillation of those documents contained in Exhibit A.

2. Commission Analysis of Disclosures:

The ninety-five companies[26/] that have made disclosures regarding possible questionable or illegal payments and related practices fit into a wide variety of industry classifications. The majority, sixty-six, were manufacturing companies. Among this number, the two largest identifiable groups were drug manufacturers and companies engaged in petroleum refining and related services. Each category is represented by twelve companies that have made public disclosure of the matters set forth herein.

The most common transactions reported were payments to foreign officials, and fifty companies voluntarily reported such payments. In addition, four of the six companies submitting reports as a result of Commission

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26/ This includes eighty-nine companies that are recorded in Exhibit A and the six companies that submitted reports as a result of Commission actions, which are summarized in Exhibit B.

enforcement action reported similar payments. Twenty-five companies reported activities that are categorized as "other foreign matters,"[27] as well as two that submitted reports as a result of enforcement action. The activities reported in this category most commonly include payments of some kind, but also include other conduct, such as violations of foreign currency and exchange laws.[28] Additionally, many of the matters reported in this category would appear to constitute a form of commercial bribery.

Fifteen companies voluntarily reported foreign political payments, as did two of the companies that filed reports as a result of commission enforcement action. Twenty-seven companies voluntarily reported foreign sales-type commissions, as well as two companies filing special reports. In some cases, the companies specifically note that circumstances

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27/ These categories overlap to a considerable degree. For example, it appears probable that some of the unaccounted for payments incident to foreign operations ultimately came into the hands of foreign officials or their designees.

28/ It should be noted that many companies reported activities that fall into a number of the categories and thus that the total numbers reported above reflect this repetition.

of the payments suggest that portions of those payments may have been used for other purposes, most frequently for possible payment to government officials.

The majority of the registrants that voluntarily reported payment of foreign political contributions indicate that such contributions are legal in the country in which they were made, and we have no basis for questioning the validity of these assertions. By contrast, although only some of the reports are sufficiently detailed to support a conclusion, we believe it a reasonable assumption that many of the cases of unusual sales commissions actually represent instances in which a portion of the payment to a foreign agent or consultant ultimately was passed to foreign government officials in order to obtain favorable treatment of some kind for the company.

The number of companies reporting domestic political contributions and other questionable domestic payments is smaller than the number reporting foreign payments. Each of the six companies that filed reports as a result of Commission enforcement actions disclosed domestic political contributions. Many of these were clearly illegal, and were reported as such by the companies.

Others, although not specifically identified as illegal, appear to have been made in circumstances that might suggest that conclusion. In addition to the six companies discussed above, twenty others voluntarily reported domestic political contributions, many of which were identified as being illegal. Thirteen companies reported other domestic matters of a questionable or illegal nature, as did two of the companies submitting reports as a result of the Commission's enforcement program.[29/]

Aside from the nature of the payments, many of the filings have dealt with four other aspects of the problem that we believe may be of interest to the Subcommittee: the potential tax consequences of these activities, their accounting treatment, the knowledge of management, and the possible impact of cessation of the practices.

29/ Two points should be borne in mind in reaching tentative conclusions from this data. First, some of the reporting companies indicate that state or federal contributions were made in circumstances that may have been or were legal. Secondly, some of the filings we have analyzed are not sufficiently clear to support a firm determination that the payments or practices were domestic or foreign. For classification purposes, these have been entered in "other domestic matters," with a cross-reference to the foreign categories. These reports are also included in the above totals.

The Commission is not in a position to ascertain the possible tax consequences of the various questionable or illegal payments or the manner in which they were made. We note, however, that thirty-seven companies in Exhibit A and five of the six companies that submitted reports as a result of Commission enforcement action have themselves indicated either that some adjustment to their federal tax liabilities is possible or that the matter is being discussed with or under consideration by the Internal Revenue Service.

Secondly, forty companies reported in Exhibit A and each of the six companies that filed reports as a result of Commission enforcement action have disclosed the particularly disturbing fact that at least some member or members of corporate management had knowledge of, approved of, or participated in the questionable and illegal activities reported.[30/]

Third, most of the instances of reported abuse also involved some falsification of corporate records or the maintenance of records that appear to be inadequate. In many

30/ This is balanced to a degree, however, by the small number of companies that reported their intention to continue questionable or illegal practices.

of the reports submitted voluntarily by corporations, the description of the payments and their documentation appears to have been inadequate to permit ready identification or verification of the purpose of the payments. Similarly, the reports the Commission obtained as a result of enforcement actions disclose flagrant instances of abuse of the system of corporate accountability, including the establishment and maintenance of substantial off-book funds that were used for various purposes, some questionable and some clearly illegal.

Many of the defects and evasions of the system of financial accountability represented intentional attempts to conceal certain activities. Not surprisingly, corporate officials are unlikely to engage in questionable or illegal conduct and simultaneously reflect it accurately on corporate books and records. We regard this to be a significant point, and one that is central to the approach we outline in Part II of this report.

Finally, although it is not possible to draw definitive conclusions regarding the possible impact of cessation of the practices reported on the foreign commercial activities of the companies that reported them, the indications in our data suggest that it will not seriously affect the ability of American business to compete in

world markets. Nineteen of the companies reporting questionable or illegal payments or practices specifically noted that cessation of the practices would have no material effect on their total revenues or overall business. Generally, it has not been suggested that cessation would seriously hamper companies' overall operations.

On the other hand, it is not possible to determine the amount of business associated with each of the reported payments. The volume of sales or other revenues reported by some companies to be "related" to the practices ranged from 20 to in well in excess of 100 times the amount of the payments themselves. One cannot determine whether some or all of those revenues could or would have been obtained without the payments or practices.

E. THE RESPONSE OF THE PRIVATE SECTOR

The Commission has attempted to ascertain the attitude of the business and accounting communities to the problems recently revealed in this area. We regard this to be a critical factor in dealing with these problems. The Commission, with its limited resources, must maximize its own effectiveness by constantly seeking to prompt the private sector's increased assumption of initiative and responsibility in dealing with

problem areas we identify. The responses in this case generally have been positive, and the Commission is hopeful that the attitudes of these two communities, which are central to the resolution of this problem, will evolve in a manner which will help ensure that the problem of questionable or illegal foreign payments is alleviated.

1. The Response of the Business Community

American business leaders have not reacted uniformly to disclosures concerning questionable or illegal payments. For example, a survey taken by the Opinion Research Corporation in July of 1975 indicated that nearly half of America's business executives saw nothing wrong with paying foreign officials in order to attract or retain contracts. Increasingly, corporate officers are beginning to speak out, however, indicating that American companies need not make such payments in order to compete effectively and urging the adoption of codes prohibiting unethical or improper conduct. Many companies have adopted such codes, including some that have reported no instances of questionable or illegal payments.

Disclosures of questionable or illegal corporate conduct also have prompted outside directors to increase their involvement in and knowledge of corporate affairs. In many cases,

these outside directors reportedly have been instrumental in initiating internal investigations and requiring more stringent auditing controls.

2. Codes of Conduct

Where questionable practices and payments have been discovered, the most common reaction has been the board of directors' issuance of a directive ordering cessation of such conduct. Additionally, many companies have adopted or reaffirmed and clarified written corporate policies prohibiting similar corporate practices in the future. A number of these corporate policy statements include recitals that employees are to conduct themselves in accordance with the highest ethical standards. The written policy statements generally have been disseminated to employees, often accompanied by letters from management emphasizing the importance of compliance. In many cases, moreover, corporations also have established procedures requiring periodic certification of compliance by key employees, and have specifically indicated that violators will be subject to disciplinary action.

Many corporate policy statements broadly prohibit the use of corporate funds or assets for any unlawful or improper purposes. Other companies have adopted more specific prohibitions. Some have prohibited political

contributions, regardless of whether they would be legal if made. In some cases the companies also have specifically prohibited payment of commissions, bribes, bonuses or kickbacks to governmental employees, and others have insisted that contracts with consultants or sales representatives specify that the payee not use any part of the payment for purposes other than those indicated in the contract. Some companies have taken additional measures, insisting that the specific services to be rendered be recited in the contract; that the amounts paid be reasonable; and that the payee agree to public disclosure of the contract.

Finally, many of the corporate policy statements prohibit establishment of any undisclosed or unrecorded funds or assets and false or artificial entries in corporate books and records. In addition, adequate and accurate documentation of all accounting entries often is required. To bolster these policies, the boards of directors of some companies have directed management to institute additional internal auditing controls.

Not all of the corporations with which the Commission has dealt regard cessation of all questionable or improper payments to be a realistic or desirable goal. Four companies have advised the Commission that they intend to continue making

certain questionable payments.[31/] Santa Fe International, while generally acknowledging the undesirability of payments to minor foreign government officials to settle tax and custom claims, has indicated that it will continue to make such payments "if no reasonable alternative exists," and if the payment is approved by the President of the Company. Similarly, Core Laboratories has expressed its intention to continue the questionable commission-type payments in cases in which refusal to do so would "adversely affect its operations in that country," provided the payment is authorized by the chief executive officer and "no reasonable alternative is available."

Rollins issued a similar policy statement, in which it indicates an intention to continue certain payments, stating that it regards the practice to be a reflection of the fact that payments to government officials are "customary" in certain countries. Finally, Castle & Cook, which has adopted a policy prohibiting the use of corporate funds for improper purposes, has advised the Commission that it intends to continue payments to foreign government employees for legitimate services, such as security, that the foreign government is unable to perform at its own expense. The Company states that it considers these

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31/ It should also be noted that many of the declarations of cessation specifically refer only to the cessation of illegal practices or to the maintenance of standards consistent with the ethical standards of the countries in which they operate. Some of these policy statements might also be interpreted as permitting similar payments in certain instances.

payments to be proper, and indicates that they were not bribes or attempts to obtain preferential treatment. Furthermore, it is attempting to arrange for such foreign governments to publish recognition of and procedures for these payments.

3. The Response of the Accounting Community

Many of the instances of improper or illegal foreign payments examined by the Commission have involved cases in which inadequate or improper corporate books and records concealed the existence of these questionable payments from the independent auditors, as well as from some or all of the members of top management and the board of directors. Some cases also involved the maintenance of funds outside the normal accountability system for similar purposes. In a number of cases, these falsifications or inadequacies have been deliberate, and represented careful attempts of some corporate executives or members of the board of directors to conceale their activities from the auditors, other company officials and members of the board. In many instances, defects in the corporate accountability system were instituted at lower levels in the corporate hierarchy.

Whatever their origin, the Commission regards defects in the system of corporate accountability to be matters of serious concern. Implicit in the requirement to file accurate financial statements is the requirement that they be based on adequate and truthful books and records. The integrity of corporate

books and records is essential to the entire reporting system administered by the Commission.

One of the most important by-products of the Commission's program to ensure adequate discovery and disclosure of questionable and illegal payments has been the increased sensitivity demonstrated by the accounting community. The independent accountant's responsibility is to certify that the financial statements of a corporation are fairly presented in accordance with generally accepted accounting principles. Accountants are not free to close their eyes to facts that come to their attention, and in order properly to satisfy their obligations, they must be reasonably sure that corporate books and records are free from defects that might compromise the validity of these statements.

In many respects, both the Commission's and the public's awareness of the magnitude and implications of the problems presented by questionable and illegal foreign payments has been evolutionary. The accounting community has become more sensitive to this evolution. And, although the responses of the accounting system have varied from firm to firm, the overall response of the profession is encouraging. An informal survey undertaken by our Chief Accountant indicates that the the following are representative of the policies and procedures adopted by the accounting profession in response to the problems we have identified.

Accounting firms have reviewed and distributed to their partners throughout the world copies or digests of relevant actions, news stories, speeches, testimony or any other data relating to these problem areas. Procedures have been established to assure that the materials disseminated are brought to the attention of all members of the firms, and that meetings are held to discuss the problem and to reinforce the accounting firms' policy directives. 32/

Major accounting firms additionally have taken specific steps to assist their clients and to meet their responsibilities to the public. For example, they have:

-- Established procedures to assure that information relating to questionable payments is brought to the attention of appropriate senior personnel. In many cases, the assignment of such responsibility to designated individuals in a firm assures that the accounting firm's response is consistent with its responsibilities to its clients and to the public;

-- Established policies to assure that questionable or sensitive transactions are brought to the attention of the board of directors, preferably through the audit committee;

32/ One accounting firm, in reemphasizing its policy directive that top management and the board of directors be timely advised of these matters, stated its position succinctly:

"We cannot overemphasize the importance and necessity of bringing these matters to the attention of top management and the board of directors on a timely basis. Any partner who takes it upon himself not to do this, must fully understand that he is seriously endangering the Firm and must be willing to accept the consequences."

-- Prepared and distributed to corporate clients educational materials to encourage their adoption of policies relating to ethics in business transactions;

-- Adopted policies of encouraging clients to make voluntary disclosures of questionable or sensitive transactions to the Commission and encouraged consultation with the Comsion regarding the procedures to be followed, and the disclosures to be made;

-- In appropriate circumstances, extended auditing procedures or required that additional procedures be followed;

-- Changed representation letters to include representations relating to the problem of questionable, improper or illegal payments. 33/

33/ An example of such a representation from management required by one accounting firm before signing the audit report is set forth below:

"You have been informed of all 'sensitive' receipts or disbursements and of any unrecorded cash or non-cash funds out of which any such payments have been or might be made, to the full extent of our knowledge thereof, including any recommendations of counsel with respect to such matters and their disclosure. 'Sensitive' receipts and disbursements, whether or not illegal, include (a) receipts from or payments to governmental officials or employees, or (b) commercial bribes or kickbacks, or (c) amounts received with an understanding that rebates or refunds will be made in contravention of the laws of any jurisdiction either directly or through a third party, or (d) political contributions, or (e) payments or commitments (whether cast in the form of commission payments or fees for goods or services received, or otherwise) made with the understanding or under circumstances that would indicate that all or part thereof is to be paid by the recipient to government officials or employees, or as a commercial bribe, influence payment or kickback."

Establishment of Professional Guidelines:

Recently, the Auditing Standards Executive Committee of the American Institute of Certified Public Accountants prepared an exposure draft of a proposed Statement on Auditing Standards regarding "Illegal Acts by Clients,"[34/] attached as Exhibit C. The draft statement discusses how accountants may become aware of illegal conduct and the inquiries that should be made if such conduct is suspected. For example, the draft indicates that, while an auditor's examination does not usually include procedures specifically designed to detect illegal acts, auditors should nevertheless be aware that illegal acts may have occurred which may have a material effect on financial statements. If an auditor believes illegal acts may have occurred, he is instructed to investigate further, consulting counsel if necessary.

The draft also discusses examination procedures performed for other purposes which may bring illegal acts to light. For example, it discusses evaluation of internal controls and related tests of transactions and balances and additionally states that the auditor's understanding of tested transactions and their

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34/ Rule 202 of the AICPA's Code of Professional Ethics requires adherance to the applicable generally accepted auditing standards promulgated by the Institute. Statements on Auding Standards are recognized as interpretations of those standards, and Rule 202 requires that members departing from these standards be prepared to justify that departure.

business purposes may lead to the discovery of transactions that appear to the auditor to have an unusual or questionable purpose. The draft expresses the view that the auditor's examination should include inquiries of the management regarding accounting for, and disclosure of, loss contingencies and related communication with legal counsel. Auditors also are instructed to inquire about clients' establishment of policy directives and their compliance with laws, regulations and procedures relevant to detection and prevention of illegal acts.

Finally, the draft provides guidance as to the possible materiality of illegal acts and the actions auditors should take upon discovering such acts. And, while it states that the auditor is under no legal obligation in the ordinary case to notify outside parties, it does indicate that, if the act is serious enough to warrant the accountant's withdrawing from the relationship, he should consult legal counsel regarding what other actions, if any, should be taken.

While the exposure draft is presently under active consideration and the Commission is not now prepared to assess the adequacy of this proposal, we have been encouraged by the profession's responsiveness. Moreover, the programs outlined

above demonstrate that the initiative and professional competence in the accounting profession are a significant resource in our continuing program relating to questionable or illegal foreign and domestic payments.

F. CONCLUSION

Certain conclusions can be drawn from the Commission's experiences to date, the many reports filed, and the reaction of the private sector concerning the overall impact these questionable or illegal practices have had on public confidence in the integrity of American business. First, the problem of questionable and illegal corporate payments is, by any measure, serious and sufficiently widespread to be a cause for deep concern. Unfortunately, the Commission is unable to conclude that instances of illegal payments are either isolated or aberrations limited to a few unscrupulous individuals. To place the matter in perspective, however, it should be noted that the 100 or so companies discussed in this report should be viewed in relation to the significantly larger number of corporations that regularly file with the Commission, a total exceeding 9000. Viewed in this broader perspective, the Commission believes that the present evidence of corporate abuse, while indeed serious, does not support any general condemnation of American business.

We do not mean to suggest that the reports filed with the Commission portray the totality of the possible problems in this area. Our Division of Enforcement presently is examining the activities of many companies that have made disclosures, and the activities of yet other companies that have made no disclosures to date. Some of these inquiries may result in a determination that the companies engaged in questionable or illegal activities that should have been disclosed to shareholders. Moreover, we suspect that some companies have engaged in similar activities that will remain undisclosed and undetected, and that others will attempt to obscure such activities in the future. We can only state that these companies run a substantial risk of discovery, since the cooperative efforts of the various agencies of the federal government are being brought to focus increasingly on these questions and the expertise and sophistication of law enforcement agencies in discovering these activities is steadily growing.

Despite the troubling aspects of the information concerning past questionable or illegal payments, the Commission believes that there is a considerable basis from which to conclude that the situation is improving, and that these episodes may serve to strengthen the quality of corporate management and public confidence in business

over the long run. This optimism rests both on the declarations of cessation, already mentioned, and, more fundamentally, on the "new governance" concept that the Commission's enforcement and disclosure programs are attempting to instill and its legislative and other proposals are designed to enhance.

Thus, in the Commission's view, while the problem of questionable or illegal corporate payments is both serious and widespread, it can be controlled and does not represent an inherent defect in our economic system. While the Committee may wish to draw its own conclusions from the analysis we have supplied, hopefully the foregoing comments concerning the patterns the Commission perceives in these data and the conclusions it draws from them, will provide a useful starting point.

PART II: LEGISLATIVE AND OTHER PROPOSALS

A. Discussion

As the foregoing discussion makes clear, the Commission has proceeded to apply its existing disclosure requirements to matters brought to its attention involving questionable or illega corporate payments. While we have not felt hampered in our enforcement efforts to date, the fact nevertheless remains that the extent of such payments is far more widespread than anyone originally anticipated, and the methods of effecting and concealing these payments are varied and multifaceted. The Commission can, and intends to, continue to enforce its existing disclosure requirements in those cases which appear to warrant enforcement action to compel disclosures about corporate operations involving such payments.

But, the question of illegal or questionable payments is obviously a matter of national and international concern, and the Commission, therefore, is of the view that limited-purpose legislation in this area is desirable in order to demonstrate clear Congressional policy with respect to a thorny and controversial problem. For this reason, the Commission wholeheartedly supports the philosophy underlying S. 3133, although we have drafted a modified version of that bill as a preferable legislative approac to the issues raised in this area.

In essence, we see three critical components for any legislative enactment governing the disclosure or making of

illegal or questionable corporate payments.

First, we believe that any legislation in this area should embody a prohibition against the falsification of corporate accounting records. The most devastating disclosure that we have uncovered in our recent experience with illegal or questionable payments has been the fact that, and the extent to which, some companies have falsified entries in their own books and records. A fundamental tenet of the recordkeeping system of American companies is the notion of corporate accountability. It seems clear that investors are entitled to rely on the implicit representations that corporations will account for their funds properly and will not "launder" or otherwise channel funds out of or omit to include such funds in the accounting system so that there are no checks possible on how much of the corporation's funds are being expended or whether in fact those funds are expended in the manner management later claims.

Concomitantly, we believe that any legislation in this area should also contain a prohibition against the making of false and misleading statements by corporate officials or agents to those persons conducting audits of the company's books and records and financial operations.

Finally, we believe that any legislation should require management to establish and maintain its own system of internal accounting controls designed to provide reasonable assurances that corporate transactions are executed in accordance with

management's general or specific authorization; and that such transactions as are authorized are properly reflected on the corporation's books and records in such a manner as to permit the preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements.

The concept of internal accounting controls is not new. It has been recognized by the accounting profession as being an important responsibility of management. Because the accounting profession has defined the objectives of a system of accounting control, the Commission has taken the definition of the objective of such a system contained in our proposed legislation from the authoritative accounting literature. American Institute of Certified Public Accountants, Statement on Auditing Standards No. 1, 320.28 (1973). The Commission is satisfied that the specifications of the objectives of a system of internal accounting controls found in the accounting literature can be readily understood by issuers and accountants. Because the dominant characteristic observed by the Commission in its program has been the presence of deliberate evasions of the systems of corporate accountability, the Commission believes that its proposed legislative approach will help foster a climate in which such attempts will be frustrated by adequate internal controls. No system can insure or guarantee complete success, but the Commission believes its approach is the appropriate one to address the problems we have observed.

We have redrafted S. 3133 to embody the foregoing legislative recommendations. Before setting forth our revised legislative proposals, however, a few comments about Sections 2, 3 and 4 of S. 3133 appear to be in order. 35/

Section 2 of S. 3133 would impose reporting requirements on certain issuers in connection with foreign payments of $1,000 or more. As we have already noted, the Commission has sufficient authority to prescribe appropriate reporting requirements for significant corporate issuers. And, while we perceive some attraction in having the Congress set certain specific levels of questionable payments that must be disclosed, we are concerned that Section 2 might deny the Commission the necessary flexibility to vary its disclosure requirements to fit the precise circumstances involved. Similarly, we are reluctant to see imposed a hard-and-fast rule requiring every reporting corporate issuer, in every instance, to identify the recipients of their foreign payments. In some cases, disclosure of the identify of the person receiving such payments may be important to an investor's understanding of the transaction. More frequently, however, the identity of a particular foreign government employee who received a payment may have little or no significance to the investor. In addition to our desire to see the Commission's

35/ Section 1 of S. 3133 largely embodies the first major tenet of our legislative recommendation, and we therefore have not specifically commmented on this provision but, rather, have modified it to comport with the overall approach we are recommending.

flexibility preserved, we are also cognizant of the fact that, as our experience to date demonstrates, in many instances corporations are unable to verify their initial pronouncements concerning the recipients of these types of payments.

Section 3 of the bill prohibits certain foreign payments outright. The Commission believes that its present statutory authority is adequate to permit effective enforcement of the federal securities laws. As previously indicated, the Commission has investigated questionable or illegal payments and related practices and has sought the prophylactic relief considered necessary under the federal securities laws. The Commission has, for example, in certain enforcement actions, sought and obtained by consent of the parties ancillary equitable relief prohibiting the defendants from making such payments. We will continue to do so in the future.

The Commission believes that the question whether there should be a general statutory prohibition against the making of certain kinds of foreign payments presents a broad issue of national policy with important implications for international trade and commerce, the appropriateness of application of United States law to transactions by United States citizens in foreign countries, and the possible impact

of such legislation upon the foreign relations of the United States.[36/] In this context the purposes of the federal securities laws, while important, are not the only or even the overriding consideration, and we believe that the issue should be considered separately from the federal securities laws.

Finally, Section 4 of S. 3133 would give the Commission authority to initiate, prosecute and appeal criminal actions arising under any of the provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934. Whether or not this provision has merit as a general policy proposition, we think that it would be unwise to divert attention from the critical policy issues posed by S. 3133 to what, in the context of this legislation, must surely be characterized as a peripheral issue. We prefer that any such provision be contained in separate legislation, at a time when full and careful debate could be had on its merits.

36/ See "The Activities of American Multinational Corporations Abroad." Hearings before the Subcomm. on International Economic Policy of the House Comm. on International Relations, 94th Cong., 1st Sess., 23-24 (1975), where a representative of the Department of State suggested that such legislation "would be widely resented abroad" and could be viewed by other governments . . . "as a sign of U.S. arrogance or even as interference in their internal affairs."

B. Draft Legislation Proposed by the Commission

The Commission proposes the following for Congressional consideration:

A BILL

To amend the Securities Exchange Act of 1934 to prohibit certain issuers of securities from falsifying their books and records, and for related purposes.

Be it enacted by the Senate and House of Representative of the United States of America in Congress assembled,

That Section 13(b) of the Securities Exchange Act, 15 U.S.C. 78m(b), is amended by renumbering existing Section 13(b) as "Section 13(b)(1)", and by adding at the end of new Section 13(b)(1), the following subparagraphs:

"(b)(2) Every issuer which has a class of securities registered pursuant to section 12 of this title and every issuer which is required to file reports pursuant to Section 15(d) of this title shall

"(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.

"(b)(3) It shall be unlawful for any person, directly or indirectly, to falsify, or cause to be falsified, any book, record, account or document, made or required to be made for any accounting purpose, of any issuer which has a class of securities registered pursuant to section 12 of this title or which is required to file reports pursuant to Section 15(d) of this title.

"(b)(4) It 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 which has a class of securities registered pursuant to section 12 of this title or which is required to file reports pursuant to Section 15(d) of this title, or in connection with any examination or audit of an issuer with respect to an offering registered or to be registered under the Securities Act of 1933."

C. Section-by-Section Analysis of Commission's Proposed Legislation

The proposal amends Section 13(b) of the Securities Exchange Act, 15 U.S.C. 78m(b) by adding new subsections (b)(2), (b)(3) and (b)(4).

Subsection (b)(2) would apply to issuers which have securities listed on an exchange pursuant to Section 12(b) of the Securities Exchange Act, 15 U.S.C. 78l(b), to issuers which meet the requirements of Section 12(g) of that Act, 15 U.S.C. 78l(g), and to issuers subject to the reporting requirements of Section 15(d) of the Act, 15 U.S.C. 78o(d). This subsection imposes an obligation on these issuers both to maintain books and records which accurately and fairly reflect the transactions and the dispositions of the assets of the issuers, and to devise and maintain an adequate system of internal accounting controls sufficient to provide reasonable assurances that, among other things, transactions are recorded as necessary to permit the preparation of financial statements in conformity with genera accepted accounting principles or any other applicable criter Because the accounting profession has defined the objectives of a system of accounting control, the definition of the objectives contained in this subsection is taken from the authoritative accounting literature. American Institute of Certified Public Accountants, Statement on Auditing Standards No. 1, 320.28 (1973).

Subsection (b)(3) of the proposal would make it unlawful for any person, directly or indirectly, to falsify any book, record, account or document maintained, or required to be maintained, for an accounting purpose with respect to each of the three classes of issuers subject to subsection (b)(2) of Section 13 of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78m(b). This subsection prohibits not only affirmative false statements but also the failure to make entries, or the failure to obtain or create documents, necessary for proper accounting records. Concepts of aiding and abetting, and joint participation in, a violation, would be applicable under this provision, in the same manner as they have traditionally been applied in both Commission actions and private actions brought under the securities laws generally.

Subsection (b)(4) would prohibit making false or misleading statements or omitting to state facts necessary to be stated to an accountant in connection with any audit of the three classes of issuers identified in subsection (b)(2) of Section 13 of the Act. This subsection would also apply audits in connection with a securities offering registered or to be registered under the Securities Act of 1933. As with subsection (b)(3) of the proposal discussed above, aiding and abetting and joint participation would be subject to this provision.

D. An Approach to Encourage the Establishment of Independent Audit Committees and Independent Counsel to Advise the Board of Directors

The legislation we have proposed should remedy the most pervasive characteristic of the cases brought to the Commission's attention in this area, namely, the deliberate falsification of corporate books and records and other methods of disguising the source or disburement of corporate funds. Action to further enhance the creation by public corporations of audit committees composed of independent directors to work with outside auditors would, however, serve as a valuable adjunct to these legislative proposals. Similarly, corporate accountability can be strengthened by making the role of the board of directors more meaningful and separating the critical aspects of the functions of the board and independent counsel. This, of course, raises questions concerning optimum relationship between outside and inside directors and whether members of law firms which have the responsibility of advising the corporation, including the board, should also serve as members of that board of directors.

The importance of the role of the board of directors, independent audit committees and independent counsel has been illustrated by the Commission's enforcement actions in the area of questionable or illegal corporate payments.

Significantly, in some of these cases no audit committee existed. In the others, with a single exception, audit committees either operated only during a portion of the time when the questionable payments were alleged to have been made, or were not wholly independent of management. Accordingly, the resolution of these proceedings typically has involved establishment of a committee comprised of independent members of the Board of Directors, charged to conduct a full investigation, utilizing independent legal counsel and outside auditors to conduct the necessary detailed inquiries. The thoroughness and vigor with which these committess have conducted their investigations demonstrates the importance of enhancing the role of the board of directors, establishing entirely independent audit committees as permanent, rather than extraordinary, corporate organs and encouraging the Board to rely on independent counsel.

With these thoughts in mind the Commission has been considering various approaches to accomplish these important objectives. As an initial step, we have asked for the views of the New York Stock Exchange with respect to a revision of its policies and practices as a practical means

of effecting them.[37/] Action initiated by the New York Stock Exchange at this time would diminish the need for further direct government regulation and set an important example for other self-regulatory organizations.

37/ See Exhibit D hereto, letter dated May 11, 1976 from Roderick M. Hills to William Batten.

EXHIBIT A

The following tables summarize the information publicly disclosed in filings submitted to the Securities and Exchange Commission on or before April 21, 1976. The filings of eighty-nine corporations are analyzed herein.* The following practices were followed in compiling these tables.

The companies that obtained the informal views of the Commission prior to making disclosures are identified by a double asterisk (**). In some cases brought to the Commission, it took no position.

The Commission's staff attempted to avoid making subjective judgments to the extent possible in compiling the charts. Whenever possible, the staff sought to characterize the conduct in as close to the company's own terms as the limited format allowed. The staff additionally avoided introducing non-public information into the charts.

The categories that are described in these tables provide only general breakdowns of the reported conduct. Obviously, conduct of the nature and variety of that set forth herein does not lend itself to easy categorization, and there is a considerable overlap among the classifications contained in the tables.

In cases in which the corporation made a statement that appeared to report a category of conduct contained in the table, a representation was entered in the charts. Where no statement of any kind was made regarding a particular category of conduct, that category was reported as "not indicated."

In compiling the tables, the Commission and its staff made no effort to verify the information contained in the public filings. Thus, the Commission's report of this information should in no manner be considered an affirmation of its accuracy or a judgment as to the adequacy of the disclosures under the federal securities laws.

Finally, although the Commission believes that the tables provide an accurate overall picture of the kinds of conduct reported herein, the limitations inherent in summarization of this kind of information render the charts an inappropriate source for determining the precise conduct of any particular corporation. The Commission suggests that persons interested in this information instead consult the public documents on which these tables are based.

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*/ The companies that submitted more detailed reports pursuant to court order are set forth separately in Exhibit B. Exhibit A does contain, however, public disclosures made by companies that have settled Commission actions but have not completed and submitted reports. Exhibit A does not contain the submissions of the J.I. Case Company and the Midwestern Gas Transmission Company. Both are subsidiaries of the Tenneco Corporation, and their filings largely duplicate that of Tenneco, which is discussed herein.

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Company	Total revenues fiscal year 1974 (thousands)	Type of statement	Domestic political contributions	Other domestic matters	Foreign political contributions	Foreign sales type commissions	Payments to foreign officials	Other foreign matters	Books and records treatment	U.S. tax liability	Knowledge of top management	Cessation
Abbott Labs**	$765, 415	Form 8–K reporting results of company's investigation covering 3 yr period.	None	Not indicated	Not indicated	Predominant part of payments were commission type that totaled $538,000 from 1973–75, with related sales totaling $8,-400,000.	Payments made in connection with "other foreign governmental actions" of $21,000 in 1975 and $121,000 in 1974. The commission-type payments were passed through to government officials and agencies	Not indicated	Entered as "sales and promotional expenses" but incomplete documentation.	Company has notified the IRS and taken steps to assure that no improper deductions will be taken in 1975. Prior returns also being reviewed.	Not indicated	Measures to insure cessation adopted, as well as requirement of consultation with top management when deviations may occur Termination will have no material adverse effect.
Allergan Pharmaceuticals	25, 396	Form 8–K reporting results of investigation covering 5-yr period.	No illegal political contributions	No payments to U.S. Government officials.	do	Payments aggregating $13,399 paid over 5 yr in 5 countries in connection with sales of $251,-804.	Payment of $4,000 in 1974 to government official to obtain a price increase for its products. Also, an unconfirmed indication of a payment of $19,500 to a customs official.	Suspicious (not confirmed) payment of $15,000 to employees of partially owned subsidiary in connection with government sales.	All payments recorded as commissions or ordinary business expenses.	Company has reported payments as commissions or ordinary business expenses and taken deductions. Additional tax stated to be minimal, however.	The senior employee abroad was aware of or authorized some of the payments. It also is possible that some US employees were aware. No evidence that the officers of the company were aware and the directors were not questioned.	Stated to be the company's policy not to make illegal foreign payments. The board has directed management to establish a written policy.
American Airlines	1, 641, 307	Report contained in proxy statement of April 1975.	Guilty plea to the Watergate Special Prosecutor for illegal contributions of $55,000. Other payments of $50,975 from 1971–73, believed legal. Another $117,474 believed contributed during period beginning as early as 1964.	Not indicated	do	Not indicated	Not indicated	Not indicated	Company maintained an off-the-books fund going back to 1964 that was funded by false charges, failure to record items, etc. The fund amounted to $275,000.	Additional taxes of $17,460 plus $9,153 in interest was paid.	Chairman of board took responsibility for political payments. Chief financial officer had also cooperated in the activities.	Yes. Company has adopted policy statement.
American Cyanamid Co.**	1, 779, 872	Form S–7 and form 8–K reporting results of investigation.	None	None	From 1971–75, payments of $10,-000 to $20,000 annually. These were legal until 1974 and illegal thereafter.	Payments during the last 5 yrs including amounts paid employees of foreign governments total $1,150,000. Range from $72,000 to $409,000 per year.		do	Payments were "recorded in Cyanamid's financial records."	No deductions were taken. Possible effect on liability not yet determined. Company believes the possible effect immaterial.	None	Payments stated to have been policy. Written policy statement being prepared.
American Home Products**	2, 048, 741	Form 8–K announcing investigation and providing a general description of the payments problems.	do	Not indicated	Contributions in 4 countries. The legality of some of the contributions appears questionable.	See payments to government officials."	Commission-type payments to government employees from 1971–75, not exceeding $668,-000 per year and aggregating $2,982,000. The related sales were $40,500,000. Also, payments to promote sales to governments not exceeding $770,000 annually and aggregating $3,-442,000 from 1971–75. Also,payments to obtain government approvals.	Legal charitable contribution of $38,000 for an "essentially political purpose" which was favored by a high government official.	All payments were recorded on books in accordance with regular accounting procedures, although supporting data or interviews were required to identify certain entries.	Amended tax returns were filed for the years 1972–74.	Corporate officers, including some of top management, knew of payments to foreign officials.	Yes. Company states that termination may result in some loss of sales and cause difficulties and delays that are predicted to be inconsequential in relation to overall sale and earnings.
American Standard, Inc	1, 676, 973	Form 10–K reporting results of investigation covering 3 yr.	do	No unlawful payments to Government connected individuals.	No illegal contributions. Legal contributions of less than $500 per year.	Commissions paid and believed passed through to government officials.	Payments in 2 countries of $66,000 over 3 yr to "persons designated by customers believed to be controlled by a national government." Payments of about $5,000 to employees in 1 country. Excessive sales commissions believed passed through $195,000 in 1975.		Payments reflected in appropriate books of account.	The company believes that there will be no effect on tax liability.	The sales commissions were known to some senior management and some members of the board.	Company attempting to dispose of subsidiary that made payments.
AMF	1, 000, 000	Form 8–K announcing initiation of investigation covering 5 yr to examine foreign payments.	Not indicated	Not indicated	Not indicated	Not indicated	Not indicated	An uncharacterized sum of $1,500,-000 paid over a 5-year period. The company indicates that this needs more examination.	Payments were reflected on the consolidated financial statements. Not documented adequately, however.	The company has notified the IRS of its investigation.	Some payments were made with the knowledge of officers, some of whom are board members, but the "questionable nature" of the payments was not apparent to them.	Yes. Company has policy prohibiting bribery and illegal political contributions and requiring compliance with laws of other countries.
American Telephone & Telegraph Co.	26, 365, 670	Form S–7 statement discloses SEC investigation into domestic political contributions of Southwestern Bell and others.	Pending investigation concerning political contributions to obtain favorable treatment from State commissioners.	do	do	Management does not believe that matters under study will have a material effect on business, financial position, or the results of the company or its subsidiaries. Not indicated	Not indicated	Not indicated	Not indicated	Not indicated	Not indicated	Not indicated.

Company	Total revenues fiscal year 1974 (thousands)	Type of statement	Domestic political contributions	Other domestic matters	Foreign political contributions	Foreign sales type commissions	Payments to foreign officials	Other foreign matters	Books and records treatment	U.S. tax liability	Knowledge of top management	Cessation
Baxter Labs**	466,284	Form 8–K reporting the results of investigation.	None	Not indicated	Subsidiaries purchased $300 of tickets for fund raising dinner, and contribution of $120 were made to a political party. Both activities were legal.	Payment of $1,943,600 since 1970 to relatives of government employees which company characterizes as legal in country where made. Similar payments of $28,000 in 5 other countries. The payments did not exceed $562,000 in any single year.	Payment of $136,800 to government employees and their relatives to obtain payment of past due receivables of $2,840,000. The payments were treated as sales deductions. Company also reports payment of $37,400 to government employees or relatives to "favorably influence government action" in other than sales matters.	Unspecified but "questionable" payment of $14,000.	Various treatment in books; sales deductions, expenses, special commissions, reimbursed employee expenses, etc.	Approximately $1,150 of payments were deducted improperly on U.S. tax. IRS 2ill be informed of the circumstances.	No member of senior management had knowledge of the payments.	Yes. Policy statement adopted.
Boeing Co	3,778,000	Form 8–K reporting the SEC's investigation and indicating that the company is conducting an investigation.	On the basis of the present investigation the company believes it made no illegal contributions.	do	Not indicated	Use of foreign agents indicated, but "no suggestion of impropriety."	Some sales agents had position with government but the company believes that none had the authority to approve purchase of its goods and services.	Not indicated	Company states that all foreign payments were reflected on the books and there was no diversion to, or existence of, slush funds.	Not indicated	Not indicated	Not indicated.
Braniff International	598,856	Form S–7 describing CAB action relating to domestic contributions and off-book fund and the existence of an SEC investigation.	Guilty plea to the Watergate Special Prosecutor for illegal political contributions of $40,000.	do	do	Ticket fund used "to promote international and foreign air travel business through practices which Braniff and the individual respondents believe were common competitive practices in the industry," including extra consideration to travel agents, tour groups and promoters. Some violated Federal Aviation Act, and may have violated IATA resolutions and foreign law.	Not indicated	do	Allegations of off-book fund created through excessive ticket sales which were not adequately reflected on the books.	IRS is inquiring into the matter	Members of the board of directors and some top officers had knowledge.	Yes.
Bristol Myers Co		Form 8–K announcing initiating of investigation.	Preliminary results make company confident that no illegal contributions were made.	do	Preliminary results make company confident that no illegal contributions were made.	See "payments to foreign officials."	Preliminary investigation indicates that "payments of questionable propriety" have been made in connection with sales to foreign governments. The company thinks they are not material and that their termination will have no material adverse effect on business.	do	Not indicated	Not indicated	Not indicated	Yes. Policy statement adopte Cessation will have no mate effect.
Browning-Ferriss Industries**	256,331	Form 8–K report with results of investigation that covered 4-yr period.	Apparent $10 000 contribution in a "jurisdiction in which corporate political contributions are not unlawful." Contribution was made against management orders.	Payments of some $110,000 in possible violation of State and local law. Some $1,500 to $3,500 for entertainment and expenses. An $82,500 payment to Government official. Gifts of $11,500 over 4-yr to public or private employees of organizations with which company does business.	Not indicated	Not indicated	Not indicated	do	1 subsidiary engaged in domestic and foreign business had incomplete records.	Company indicates that the matter has been referred to tax counsel.	Yes, in some instances	Yes. Policy statement adopte Termination will have no mat rial adverse effect on busine
Burroughs Corp	1,510,835	8–K indicating SEC investigation and the company's investigation.	Not indicated	Not indicated	do	See "other foreign matters"	See "other foreign matters"	From 1973–75, some $1,500,000 was withdrawn from a foreign subsidiary and used in connection with sales, including some to agencies of foreign government. The sums normally were added to the price of the goods sold.	Fictitious invoices were used to withdraw money from subsidiary.	Amounts of withdrawals were included as deductable expenses for income tax purposes.	No member of board of directors had any knowledge of the transactions.	Yes.
Butler National	1,489	Amendment to form 10–K indicating 1 instance of payment.	do	Payment of some $200,000 to employees or entities having business relations with company. Not identified as foreign or domestic.	do	Not indicated	Commission of $102,000, approximately 36 percent of the sales price, to government employee who "could have influenced" government's decision.	See "other domestic"	Yes. Company maintained 2 improper "cash funds" of some $270,000 over a 5-yr period. They were funded by fictitious purchases and false expense reports.	Amended tax returns filed affecting loss carryforwards.	Not indicated	Yes.
Carnation**	1,889,353	Form 8–K and proxy statement reporting investigation.	do	Not indicated	do	do	Payment of $1,261,000 from 1968 to 1976 to expedite or influence regulatory action by foreign governments. The payments did not violate U.S. law, but some were illegal or improper under foreign laws.	Not indicated	A special account was maintained for payments on the books.	No deductions had been taken relating to the payments.	5 directors, all of whom were nominees for reelection and including chairman of the board, president, executive vice president and senior vice president, know of "virtually all" of the payments.	Yes. Company is not certain im pact on future business.
Carrier Corp	984,681	Form 8–K reporting the issuance of a press release concern- results of investigation.	None	do	None	$2,161,000 paid over period of 4 yr, of which $453,000 was paid to government employees.	$453,000 during 4 yr period.	do	Not indicated	Not indicated	Not indicated	Yes.
Castle & Cook**	753,131	Form 8–K report indicating results of investigation.	Not indicated	Money was passed through special in connection with anticipated port strike. Some $140,000 paid to contractor to arrange for unloading vessels. Counsel is of opinion that the payment was legal.	$30,000 in 2 contributions that were legal where made.	Not indicated	Numerous small payments, averaging about $80,000 per year. Most made to army personnel who guard plant and employees in remote areas, and to minor port officials. Company does not consider these payments to be improper, and states that they were not paid as bribes or attempts to obtain preferential treatment.	do	Most payments made from a special checking account maintained for that purpose and a record of the account was transmitted monthly to accounting headquarters.	do	Senior management was aware of the payment arrangements.	No payments claimed to be "gen erally accepted in the countries" and essential to the protection of employees.
Celanese Corp.**	1,928,000	Annual report indicates that review revealed nothing "of a material nature."	do	Not indicated	Not indicated	do	Not indicated	Not indicated	Not indicated	do	Not indicated	Company states that "any question able practices were terminated." It expects no significant loss o revenues as result of termination

Company	Total revenues fiscal year 1974 (thousands)	Type of statement	Domestic political contributions	Other domestic matters	Foreign political contributions	Foreign sales type commissions	Payments to foreign officials	Other foreign matters	Books and records treatment	U.S. tax liability	Knowledge of top management	Cessation
Cerro Corp	781, 901	Proxy statement disclosing SEC inquiry.	Not indicated	Not indicated	Not indicated	Company has revealed SEC investigation into matters "not material" to its continuing business.	Not indicated	Not indicated	Not indicated	Not indicated	Not indicated	Not indicated
Cities Service **	2, 806, 300	Form 8–K reports, and form S–7.	do	do	Expenditures of $30,000 for "political purposes," that were disguised on books and records of subsidiary. Company was informed that subsidiary believed that none of the funds were paid to government officials.	Not indicated	do	Subsidiary maintained off-book fund of some $600,000 since 1973, created form rebates on sales. Funds appear to have been used for business purposes. Payment of $15,000 to foreign lobbyist.	Yes. Swiss bank used to transfer some of moneys and improper records of subsidiaries, including misstated revenues. The payment to lobbyist originally was recorded as technical service.	Some improper deductions, and amended tax return filed. The IRS will be contacted.	Senior management, including some who were directors, knew of the $30,000 payment but were told that the subsidiary had been informed by local counsel that the payment was legal. The legality of the payment now "is not free from doubt," however.	Yes. Policy statement adopted.
Coastal States Gas	1, 315, 265	Form 8–K announcing investigation.	None yet discovered	None yet discovered	None yet discovered	As yet unconfirmed report that part of brokerage commissions were passed on to foreign government employee. The brokerage fees totaled $8,000,000.	Suspected payment identified in "foreign sales-type commissions."	Not indicated	None yet discovered	Not indicated	None yet discovered	Do.
Coherent Radiation	14, 469	Annual report for 1975, notes to financials.	Not indicated	Not indicated	Not indicated	Payment of $20,388 to sales representative. Portion paid to official of foreign agency.	Not indicated	do	Not indicated	do	The company was advised at the time the payment was made.	Not indicated.
Colgate-Palmolive Co	2, 615, 448	Form 8–K containing company policy and results of investigation that covered 5 yr.	None	do	None	Not indicated	Payments totaling $315,000 in 6 countries over 5 yr, of which $260,000 was part of "usual" trade discounts. Remaining payments for price increases, settlements, etc. Also, company reports payments of $550,000 over 2 yr to a corporation designated by a foreign customer who resold products to the government.	do	Approximately $67,000 may not have been properly reflected on the books of a subsidiary.	Company reports that any tax liability "will be minimal."	Management was aware of payments made to corporation designated by foreign official.	Yes. Policy statement adopted.
Combanks	15, 160	Form 8–K indicating investigation prompted by testimony given by company president under grant of immunity.	President made contributions of some $100,000 from 1967–73, to Federal, State, and local officials from account maintained by officer of affiliated bank. President testified that, although money was that of the officer, both thought that it was available for political contributions.	Questionable transactions in which the president and corporation purchased and sold shares in 2 separate Florida banks.	Not indicated	do	Not indicated	do	Not indicated	Possible tax liability to be indemnified by the President.	Yes, as is indicated	Reimbursement by president and cessation of activities by him.
Cook Industries	456, 638	Forms 10–K and 8–K disclosing Government investigation.	Not indicated	Investigation not complete but company believes that certain of its employees may have been involved in violations relating to grain transactions and other such matters as bribery and intimidation of federally licensed grain officials, and the company has "some basis to believe that certain of its employees, without the knowledge of senior mangement, may have been involved in violations of the (Federal) acts."	do	do	do	do	Indictments allege improper and fraudulent weighing of grain and falsification of records and license certificates.	Not indicated	Information obtained to date indicates that the activities were conducted without the knowledge of senior management.	Yes. Policy statement adopted.
Cook United Inc	446, 135	Form 8–K reporting the results of investigation.	do	Payment of $6,162.66 to "persons not employed by registrant or its subsidiaries." It is not clear whether payment reported was domestic or foreign, however.	do	do	Not indicated, but see other domestic.	Not indicated, but see other domestic.	Not indicated	do	Not indicated	Do.
Core Laboratories, Inc	24, 202	do	None	None	None	do	Payments of some $86,000 to employees of a single foreign government through inflated bids and invoices. In 1975, $96,385 was paid in the same county in connection with settlement of tax claims, and $2,100 was paid in connection with a license renewal.	None	Payments recorded as outside commissions, cost of sales and sales commissions.	Company will eliminate a $2,000 deduction previously claimed and amend tax return.	Yes	Company states that it is not its policy to make payments of this nature and that it does not intend to initiate or suggest them in the future. If refusal to make requested payment would adversely effect operations, payments might be authorized where no reasonable alternative is available. In such cases, the payment must be approved in advance by the chief executive officer, recorded properly on books, and disclosed.
Del Monte	1, 274, 000	Annual report disclosing existence of Guatemalan investigation into the circumstances of purchase of banana properties. Regulatory agencies in United States were notified.	Not indicated	Not indicated	Not indicated	The investigation, which had not been concluded, centered on payments to a consultant regarding negotiations of property purchase. The company indicated its belief that it was unlikely to suffer any adverse financial effect as a result of inquiry.	Possible, see "foreign sales-type commissions."	Not indicated	Not indicated	Not indicated	Not indicated	Not indicated.

Company	Total revenues fiscal year 1974 (thousands)	Type of statement	Domestic political contributions	Other domestic matters	Foreign political contributions	Foreign sales type commissions	Payments to foreign officials	Other foreign matters	Books and records treatment	U.S. tax liability	Knowledge of top management	Cessation
Diamond International	782, 568	Form 8–K	Revealed voluntary disclosure to federal authorities of illegal political contributions and guilty plea of the company and a vice president to contributions of $6,000.	Not indicated	Not indicated	Not indicated	Not indicated	Not indicated	Not indicated	Not indicated	Yes	Yes. The corporation's fine also was reimbursed by the chief executive officer.
Diversified Industries	281, 865	Form 10–K for fiscal year ended October 1975.	Not indicated	Allegation in civil suit that cash fund of some $270,000 was maintained from 1972–75 and that payments of $200,000 made to company employees. 1 $5,000 payment alleged in another company division for unknown purpose. Remainder not verified, but $35,000 was returned to general funds.	do	do	do	do	The 2 cash funds were maintained through false sales and false expense submissions.	Company filed amended returns and reports no additional tax required. Company indicates that it will have to decrease its net operating loss carryforward.	Not indicated	Yes. Policy statement adopted. Matters discovered do not require change in the financial statements.
Dresser Industries	1, 397, 970	Form 8–K announcing investigation.	do	Not indicated	do	do	Existence of "unreceipted payment" of $24,000 in connection with a tax settlement.	do	The unreceipted payment to settle tax liability was described on the books as such.	No deductions taken for unreceipted payment.	do	Yes.
Electronic Associates, Inc	(1)	Form 8–K reporting results of investigation.	Possibly some $1,150 paid to domestic political parties by former officer who was reimbursed by the company.	do	do	do	Payments of $83,000 to minor government officials of 6 countries during the years 1971–75.	do	Substantially all were recorded to be commissions, cost of sales or public relations expenses. Investigation discovered no offbook funds.	Not yet determined, but company believes that revisions, if any, would be immaterial.	Some officers and directors knew of payment in 1 instance and did not take action.	Company has reaffirmed its policy against illegal or improper conduct but indicates uncertainty of its impact in countries where such payments are customary.
Exxon	45, 792, 858	Form S–7 indicating shareholders' derivative suit alleging improper expenditure of $59,000,000, as well as SEC and congressional inquiries.	Not indicated	do	Contributions in Italy, legal in that country, averaging $3,000,000, per year and totaling $27,000,000 from 1963 to 1971. Additional unauthorized political contributions of a claimed amount of $19,000,000 were made by managing director of Italian sub. Managing director claimed these to be political contributions, but management can't verify that fact. Contributions of $31,000 in 2 other countries in 1972.	do	Payments of some $740,000 from 1963 to 1975. Of this sum, $10,000 was made after mid-1973. Payments of $13,000 per year to legislator who served as consultant. Some $8,000 of improper payments to customs officials in 1973 and 1974.	Unauthorized transactions and payments by managing director of Italian subsidiary of about $19,000,000; payment of about $10,000,000 to Italian oil organization for certain sales arrangements.	The Italian political contributions were recorded through invoices for services as payments to sales organizations. Other payments were made in cash from off-book fund. Also, improper recording of some other payments and maintenance of secret bank accounts not maintained on the books.	Italian payments did not reduce U.S. taxes at any time.	Officers who were members of board of directors and management of regional offices either knew of the transactions or authorized them.	Policies and procedures adopted to stop illegal payments and the falsification of books and records.
Fairchild Industries	256, 654	Form 8–K reporting results of investigation.	do	do	Not indicated	do	Not indicated	Not indicated	Not indicated	Not indicated	Not indicated	Yes. Corporate management has revised its policies. The magnitude of the practices is stated to be not material to future business.
Gardner-Denver Co.**	423, 000	do	No illegal contributions	do	do	Invoice or supplier's certificate in 4 countries indicate smaller commissions than were paid, but the full commission was on This practice has been discontinued.	From 1971–76, $62,200 was paid to government employees. Also, a $7,000 payment to a government employee in connection the books for tax purposes.	Foreign subsidiary has made sales to foreign country that U.S. companies and their subsidiaries are not permitted to deal with. This was volunatrily reported to Commerce Department and ceased. Also, $27,000 paid to an employee of an independent distributor to promote sales.	All payments were recorded on subsidiaries' books except for the $7,000 payment, which was recorded on books of the parent.	Additional tax liability indicated	No	Yes. Company has adopted policy statement.
General Telephone & Electronics Corp.	2, 841, 850	do	No illegal political contributions	do	Payments of approximately $182,000 over 5 yr that were legal where made. 1 improperly recorded.	Payment of $176,000 by subsidiary to marketing representative and it is not clear that improprieties were not present.	Payments of $2,210,639 from 1971–75, as well as payments to 3d parties of $5,602,816 where it seems likely that some portion was passed on to government officials.	Payments relating to bribery of officers of foreign companies of $5,086,028 from 1971–75.	False invoices used to generate cash for some payments. Some of subsidiaries' books did not reveal nature of the transactions. Some off-book accounts also were discovered.	Company has advised the IRS	Outside directors not aware. Management directors were involved in some transactions, but may not have beed aware of circumstances of or seriousness of conduct.	Yes. Matters discovered will not materially affect assets.
General Tire & Rubber Co	1, 756, 646	10–K revealing investigation requested by SEC after disclosure of Chilean transaction. Preliminary results of investigation reported.	Investigation will inquire into this matter. No disclosures made.	do	Not indicated	Consultant fees of $800,000, of which $300,000 has been paid to date to Morrocan private consultant in connection with negotiation of contracts and licenses. The consultant was under investigation for some time, but not indicated. 2 Morrocan officials were indicted in connection with 1 of the transactions, however. Payment of $90,000 to private Romanian citizen in connection with contract negotiation, believed legitimate by company. For reasons not known, however, sum was paid from INSA foreign bank account, resulting in payment of $90,000 to Chilean Government. Unrecorded cash fund, formed from rebates, from which $24,000 was paid over 6 yr for executive compensation and improper and illegal purposes. Off-book fund once approximately $435,000 that appears to have violated local currency laws.		Not indicated	Not indicated	Not indicated but said to be subject of continuing investigation.	Yes.
B. F. Goodrich Co	1, 975, 244	Form 8–K with preliminary report of investigation.	None	do	None	Commission-type and expediting payments to government officials in 2 counties of not more than $31,000 total from 1971–75. Sales related to the commissions were $276,000.	See "other foreign payments"	Payments totaling less than $93,000 from 1971–75 to 3d parties that may have been passed on to some government officials for expediting purposes.	Disclosed on books but not fully disclosed on invoices.	None	None	Yes. Termination will not have material effect on business.

Company	Total revenues fiscal year 1974 (thousands)	Type of statement	Domestic political contributions	Other domestic matters	Foreign political contributions	Foreign sales type commissions	Payments to foreign officials	Other foreign matters	Books and records treatment	U.S. tax liability	Knowledge of top management	Cessation
Goodyear Tire & Rubber Co	5,256,247	Proxy statement reporting domestic contributions and form 8–K reporting results of investigation into foreign matters.	A foreign bank account, funded from volume discounts on foreign sales was used as the source of domestic contributions. The account was started in 1964. Over 6 yr, some $260,000 was trans- chairman of the board and company plead guilty to making an illegal $40,000 contribution in 1972.	Not indicated	Not indicated	As reported in "foreign officials".	Direct payments of $120,000 over 6-yr period, plus indirect payments of $375,000 that probably went to government employees. Possibly another $350,000 in commissions to government employees in 6 yr in connection with sales of about $9,000,000. Unspecified number of payments of less than $1,000 each to minor functionaries for services that the foreign subsidiary was entitled to receive.	Not indicated	Foreign fund used for domestic contributions. Also, 3 foreign subsidiaries had off-book funds from which some foreign payments were made. In 6 yr, about $680,000 went through these funds, some 75 percent of which was used for legitimate business purposes.	Company states that additional taxes, if any, will be minimal.	Some officers had knowledge of domestic political contributions but not of foreign transactions.	Yes. Policy statement adopted. The company states that termination will have no material adverse effect.
Harrah's	127,816	Form S–7	Contributions of $17,500 in possible violation of Federal Election Campaign Act. Company was reimbursed by Mr. Harrah.	do	do	Not indicated	Not indicated	do	Not indicated	Not indicated	Not indicated	Yes.
Honeywell	2,600,000	Exhibit to form 8–K, reporting results of investigation.	None except for nominal State and local contributions that were legal where made and discontinued in 1974.	No violation of applicable U.S. laws.	No illegal contributions	do	Payment of some $850,000 from 1971–75 to local government officials and employees, mostly at a low level, in connection with sales. In some cases these were for technical services that would have been performed by others. 13 expediting payments of $190,000 from 1971–75.	Company reports payments of $800,000 to employees of private customers in connection with sales. In many cases, the payments were for technical services that were actually rendered. Other indications that subsidiaries engaged consultants and agents without formal contracts or invoices, but services were rendered.	3 small unrecorded bank accounts of subsidiaries involving less than $150,000. Faulty documentation of other payments.	No revisions are required in U.S. consolidated returns.	No involvement or prior knowledge of payments by directors or officers.	Yes. Policy statement adopted.
Hospital Corp. of America	297,747	Form S–7 registration statement	Not indicated	Not indicated	Not indicated	Payment to foreign consultant pursuant to contract. The full extent of services and disposition of fees not known, but company believes that payments and contract were legal.	Not indicated	Not indicated	Payments to consultants reported on books as "services performed."	Not indicated	Yes	Not indicated.
Ingersoll-Rand Co	1,414,788	Form 8–K announcing investigation.	do	do	do	Not indicated	do	do	Not indicated	do	Not indicated	Do.
Intercontinental Diversified Corp	64,143	Form 10–K for fiscal year ending Oct. 31, 1975.	do	do	Contributions from 1971–75 as permitted by local law.	do	Not indicated	Management believes the matters under study will not have a material effect on company's assets or reported earnings. Payments during 1970–72 of $329,320 to foreign corporation in connection with spin-off type transactions.	Political contributions included in financial statements as charge against income. Purpose of payments in connection with spin-offs not indicated.	None	do	Do.
ITT	11,154,401	Form 10–K and proxy statement reporting results of investigation.	From 1971–75, various subsidiaries expended approximately $4,300 in purchasing tickets in fund-raising events, incurring other minor expenses and making minor contributions that could be considered directly or indirectly to be contributions to Federal election campaigns. The domestic and foreign contributions totaled $64,300 from 1971–75, of which $60,000 was made in jurisdictions where legal.	Small payments to Government functionaries to expedite administrative action or secure procedural assistance. The total amount of these payments is considered insignificant.	Foreign and domestic political contributions totaled $64,300 from 1971–75, of which $60,000 was given in jurisdictions where contributions are legal.	In addition to customary commissions, approximately $3,800,000 paid from 1971–75 to assist in developing or improving business opportunities and relationships. The corporation has reason to believe that all or a substantial portion of this sum was ultimately received by employees or persons closely related to commercial and governmental customers.	See "foreign sales-type commissions." Also, payments or presents of modest value to government functionaries to expedite administrative action or to secure procedural assistance.	See "foreign sales-type commissions."	Substantially all of the sales-type commissions were recorded, but the accounting entries were sometimes insufficient. A minor portion of the domestic political contributions were not recorded or were improperly recorded. Some legal transactions were improperly recorded. Corporate books of some foreign subsidiaries did not reflect tax liability when they were acquired. Company has substantially completed its negotiations with governments and regularized the books.	Company expects no significant effect on U.S. tax liability.	Neither the board nor senior officers authorized the practices.	Appropriate steps will be taken to assure there is no repetition. The companies against such practices were affirmed and new procedures were adopted.
Johnson & Johnson	1,967,885	Form 8–K reporting results of investigation.	No	No payments to recipients in United States.	No	Payments made with understanding that they would go to government officials. See "government officials."	7 subsidiaries made payments of $990,000 from 1971–75 with the understanding that government officials were involved. About 94 percent were commission-type; remainder were expediting payments.	Payments of $12,300 originated in United States that were associated with exports.	Charged to variety of accounts but were subject to regular control of the subsidiary involved.	Improper deduction of $280. IRS will be notified, but no United States return to be amended or filed.	No members of board or executive committee and no present executive officers knew of or approved payments.	Yes. Company states that the related business was not material.
Koppers Co., Inc	914,184	do	None	Not indicated	No illegal contributions	Approximately $1,500,000 paid in violation of company policy as commissions in foreign countries, primarily to, and at the request of, persons connected with the customer. Payments did not exceed the reasonable amount for commissions, however.	None	Not indicated	No books and records problems were discovered.	The IRS has been advised of developments and prior tax returns are being reviewed.	Neither senior management nor the board of directors had knowledge of the payments.	Yes.
Kraftco Corp.**	4,500,000	Form 8–K indicating results of investigation.	Contributions totaling $550 from 1972–76 that may have been illegal.	do	Contributions totaling $8,500 from 1972–76 in countries where legal.	Not indicated	Payments totaling about 200,000 from 1970–75 to tax consultants, minor government employees and union officials. About $145,000 of this sum was paid to a tax consultant, and the company has no knowledge of impropriety.	2 accounts not reflected on books over last 10 yr involving expenditures of $491,000 over 8 yr. Payments for employee compensation and payments to 3d parties of questionable legality or propriety.	Yes, 2 off-book accounts in foreign countries, but 1 of these accounts was included in the company's consolidated financial statements.	None	Several members of management were aware generally of the off-book accounts.	Yes.

Company	Total revenues fiscal year 1974 (thousands)	Type of statement	Domestic political contributions	Other domestic matters	Foreign politcal contributions	Foreign sales type commissions	Payments to foreign officials	Other foreign matters	Books and records treatment	U.S. tax liability	Knowledge of top management	Cessation
Levi Strauss	4,500,000	Form 8-K announcing investigation.	Not indicated	Not indicated	Not indicated	Not indicatod	Payments of about $75,000 in 1974–75. Company cannot determine whether payments led to improper benefits since it received similar benefits, primarily tax credits, in prior years without making payments.	Not indicated	Not indicated	Not indicated	Not indicated	Yes.
McDonnell Douglas	897,700	Form 10-K announcing results of investigation.	No illegal political contributions	do	do	During 5¼-yr period, a portion of commissions appears to have gone to foreign officials. The total amount involved was $2,500,000.	Payments to foreign officials; see "commission-type payments."	None	Company's independent accountants are of the opinion that expenditures were properly identified in accounting records and reflected in the financial statements.	Additional taxes will be paid on such amounts as ultimately determined to be nondeductible.	do	Not indicated.
Mercantile Bankcorporation Inc	3,117,869	2 form 8-K's with reports	Officers establish fund, existing from 1968–75, for political contributions. The bank did not participate or reimburse the officers. Contributions averaged $10,000 per year and were not coerced, Company indicates and that it has been discontinued.	Loans and advances on favorable terms to trust sponsored by chief executive officer. Loans and purchase of securities in excess of market prices.	do	Not indicated	Not indicated	Not indicated	Not indicated	Not indicated	Yes	Yes.
Merck & Co	1,329,550	Form 8-K with preliminary report of results of investigation.	No	Not indicated	Payments totaling $157,684 from 1968–75 that were legal under local law but improperly recorded on books.	Some commission-type payments passed on to government officials.	From 1968–75, $3,603,635 of which $2,305,000 represents special commissions, paid to 3d parties who may have passed money on to government employees. Company indicates that not all of payments may have been improper. Generally paid to mid- and lower-level officials 1 $12,500 payment made to Cabinet-level official, however.	do	Payments classified as business expenses, commissions, fees, marketing services, etc. Political contributions entered as promotional expenses or public relations expenses.	Improper deductions prior to 1974, Amended returns for 1972 and 1973 filed and additional $264,000 was paid. IRS is presently reviewing the matter.	General knowledge of a number of the payments.	Yes. Policy statement adopted.
Missouri Public Service Co	63,971	Registration statement on form S-7.	Contributions of $51,865 from 1968–76 made by club formed by senior employees.	do	Not indicated	Not indicated	Not indicated	do	Amounts deducted from employee salaries for political contributions included in operating expenses.	Not indicated	Members of the board of directors involved in the conduct relating to political contributions.	Yes, pursuant to settlement agreements with State and Federal officials.
NCR Corp	899,787	Form 8-K announcing investigation	Not indicated	do	None	From 1977–75, amounts added to price of equipment of $300,000 to $500,000, alleged for parts training, support services, etc., but they may have been utilized for unauthorized purposes.	do	do	A special fund used for training personnel and support services appears to have been used for payments as well. Fund was formed by overbilling customers with their knowledge.	There are no U.S. tax consequences with respect to the payments.	No member of senior management or board of directors was aware of the payments.	Yes. Policy statement adopted. Company does not believe that cessation will materially affect revenues or assets.
Northwest Industries, Inc	103,700	Form 8-K reporting results of investigation.	do	do	Not indicated	Not indicated	Payments made by 1 subsidiary to government connected persons in connection with sales not exceeding $102,000 in 1973, $158,000 in 1974, and $222,000 in 1975. The related sales totaled approximately $14,000,000, $17,000,000 and $19,000,000 in the respective years. Another subsidiary made similar payments of approximately $35,000 and $65,000 in 1973 and 1974 in connection with annual purchases of some $2,000,000. Some portion of all of these payments, the precise amount of which cannot be determined, was for expediting port clearances, shipping arrangements, etc.	do	No transactions were discovered that were not properly recorded on the appropriate account. The company also states that the investigation uncovered the existence of no slush funds and no instances of laundered money.	The IRS has been advised that returns will be corrected to the extent that any improper deductions have mistakenly been reflected on the returns.	No directors had any knowledge of the payments.	Yes. Cessation will not have a material effect on consolidated business.
The Offshore Co	133,400	Form 8-K announcing preliminary results of investigation.	None	None	None	None	Payments to expedite government actions, amounting to less than $15,000 per year.	Payment to 2 consultants to expedite regulatory approvals, totaling $154,000. The company has no knowledge whether the payments were made to government officials.	Irregularities in the accounting system of foreign subsidiaries were discovered. The payments were recorded but in some cases inadequate documentation was provided.	None	General awareness and in some cases approval.	Yes. The Company indicates that there will be no material effect on revenues and income.
Ogden Corp	1,858,119	Form 8-K reporting results of investigation.	Certain persons who were not announced candidates provided services of company airplane until 1974 at a cost of $40,000. Former subsidiaries made illegal contributions of $16,200.	Not indicated	Not indicated	Yes. The company indicates that it believes they were reasonable.	Some $150,000 paid in small gratuities to expedite port clearance in foreign countries. Payment of $25,000 by subsidiary for a variety of services, some of which were performed by government employees.	From 1973–75, $140,000 paid in foreign country to employee of customer in which the government had a major equity interest From 1970–75, some $2,100,000 added to sales price as accomodation to customers and deposited in bank in 3d country according to customer's instructions.	No transactions that were not recorded on books or where the use of money was falsely described.	Not indicated	Yes	Yes.

Company	Total revenues fiscal year 1974 (thousands)	Type of statement	Domestic political contributions	Other domestic matters	Foreign political contributions	Foreign sales type commissions	Payments to foreign officials	Other foreign matters	Books and records treatment	U.S. tax liability	Knowledge of top management	Cessation
Otis Elevator		Form 8-K indicating initiation of an investigation.	Not indicated	Not indicated	Under investigation	Under investigation	Under investigation	Under investigation	Not indicated	Not indicated	Not indicated	Not indicated.
Pacific Vegetable Oil	210, 317	Form 10-K announcing results of investigation.	do	do	Not indicated	Not indicated	Not indicated	For last 2 fiscal years, company received $1,170,000 as a distribution of profits, in violation foreign country's withholding and exchange laws.	Tax reports in country exclude certain matters but consolidated books are accurate.	It is not clear whether penalties for foreign taxes will have any effect.	do	Do.
Pfizer, Inc	1, 571, 887	Form 8-K reporting results of investigation covering 3 yr.	do	do	Possible payments, see "other foreign payments."	do	2 instances, totaling $28,500, of expediting payments; $45,000 annually for 4- 5-yr period in connection with sales. Total of $10,000 paid in matters involving government business.[2]	$22,500 payment to foreign trade association for possible political payments and the payment of $21,000 in "professional fees" part of which may have gone to government employees.[2]	Not indicated	Not indicated	do	Long standing policy forbiding briberty of government officials and political contributions policy reaffirmed by the company and the audit procedures were strengthened.
Public Service Co. of New Mexico	67, 367	Form S-7	Company indicates existence of grand jury investigation regarding possible violation of Federal law in connection with possible contribution. $9,656, paid a private company, may have been passed on to candidate.	do	Not indicated	do	Not indicated	Not indicated	do	do	Company's officers are included in investigation.	Not indicated.
Pullman Inc	1, 425, 587	Form 10-K reporting investigation covering 5 yr.	None	None	None, although some commission payments may have been passed on.	From 1973–75 $100,000 and $25,665 in foreign currency paid to secure work.	From 1973–75, some $2,150,000 paid as fees and commissions to secure work.	do	Recorded as fees and commissions.	Company has discussed the matter with the IRS.	None	Company policy against violation of domestic and foreign laws affirmed. Foreign agents now required to represent that commissions will not be passed on to others.
Republic Corp	225, 648	Annual report with statement in note to financials.	Not indicated	Not indicated	Not indicated	Foreign sales were made through commission agents. The company's review of the practices does not indicate that corrective action is necessary, however. Company indicates that the SEC is reviewing the matter.	Not indicated	do	Not indicated	Not indicated	Not indicated	Not indicated.
Richardson-Merrill, Inc	582, 146	Form 10-Q reporting results of investigation.	None	None	None	See "other foreign payments"	do	Payments of questionable legality in relation to sales. Amounts of the payments and the related sales are considered not to be material by the company.	do	Expected to be minimal	do	Yes.
Rockwell International	4, 408, 500	Form 8, amending previous form 8-K and reporting results of investigation.	Not indicated	Not indicated	$8,300 in Canada, where the contribution was legal.	Not indicated	From 1971–75, $668,000 were or may have been paid in connection with sales of $10,100,000.		Recorded as sales commissions, but some questions as to some of the payments.	Company is reviewing its tax returns.	No	Yes, and a reaffirmation of company policy.
Rohm & Haas Co	1, 021, 736	Form 10-K containing results of investigation.	None	None	None	do	From 1971–75, some $427,400 paid to lower level employees in connection with sales of $3,000,000; permits, and loans. Payments of $165,000 in customs matters.	From 1971–75, payments of $157,000 that violated exchange and price controls.	Of the total, $463,000 was not reflected on the local books and records and $219,000 was misclassified.	The maximum tax deficiency that could result from disallowance of foreign tax credits will be less than $100,000.	Some awareness of some of the practices by members of top management.	Yes. Cessation will not have a material effect on revenues.
Rollins, Inc.**	193, 297	Form 8-K with report of findings	Not indicated	Not indicated	Not indicated	None	From 1971–75, payments of $127,000 of "questionable legality" made to municipal officials to install equipment. Revenues related to payments are some $2 million annually.	None	Not indicated	None	Yes	No. The company states that the payments are "customary" in the country and that it will authorize similar payments in the future when "no reasonable alternative is available."
Sanders, Associates	180, 936	Annual report quotes the reply of a corporate officer to a question on foreign payments raised by a shareholder.	do	do	do	The company indicates that it pays sales commissions in connection with foreign business. Review of its arrangements shows none in violation of U.S. policy.	Not indicated	Not indicated	do	Not indicated	No	Not indicated.
Santa Fe International**	255, 912	Amendment to form S-7. Form 8-K and amendment on form 8.	Continuing inquiry has revealed no illegal contributions.	do	Continuing inquiry has revealed no illegal contributions.	Not indicated	Questionable payments aggregating $66,140 during past 4 yr. The payments were made in an attempt to resolve claims initiated by foreign officials in connection with tax and customs matters, which the company considers improper or illegal.	do	Continuing inquiry has revealed no "stush funds" maintained outside the system of corporate accountability or "kickbacks."	do	Not indicated	Company indicates that payments are undesirable but that it will continue to make them "if no reasonable alternative exists" and the payment is approved by the President.
Schering-Plough Corp	726, 872	Form 8-K announcing initiation of investigation.	No illegal contributions	do	Not indicated	See "foreign officials."	Payments not exceeding $207,000 per year in connection with $2,300,000 per year.	do	Not indicated	do	do	Not indicated.

Company	Total revenues fiscal year 1974 (thousands)	Type of statement	Domestic political contributions	Other domestic matters	Foreign political contributions	Foreign sales type commissions	Payments to foreign officials	Other foreign matters	Books and records treatment	U.S. tax liability	Knowledge of top management	Cessation
G.D. Searle & Co	621, 310	Form 8–K and form 8	No illegal contribution	None	None	See "foreign officials"	Payments to secure work, totaling $1,303,000 from 1973–75, which were related to sales of $11,-500,000. The legality of these payments under local law is "not free from boubt."	None	Recorded in the books as marketing expenses.	Inappropriate deductions in connection with payments. Estimated liability of $84,000 for 1973–74.	Managers of subsidiaries authorized the payments. Certain members of corporate management were generally aware of some payments and in some cases authorized them.	Yes. Policy statement adopted.
Security New York Corp	2, 587, 000	Form 8–K	Officers of the company have been subpenaed in connection with an investigation for violations of New York election law. The company believes that it acted within the scope of the law.	Officers received fees which were later allegedly contributed to political campaigns.	Not indicated	Not indicated	Not indicated	Not indicated	Not indicated	Not indicated	Not indicated	Not indicated.
The Singer Co	2, 587, 000	Report of investigation on form 10–K and proxy.	Grand jury indictment involving $15,000 contribution charging company and lower level employee.	Not indicated	do	do	do	do	do	do	Top management was not aware of the contributions.	Do.
Smith International	199, 501	Amendment to form S–7	Not indicated	do	do	do	Payment of $13,349 to tax consultant which was to be passed on to government officials. The company cannot verify whether some of the money was in fact passed on to the official, however.	do	do	do	No	Yes, and previous policy reaffirmed.
Southern Bell Telephone & Telegraph Co.		Form S–9	Former employees made allegations of illegal contributions.	North Carolina Commission found that $142,000 was improperly accounted for. The purpose of this money was not disclosed, however.	do	do	Not indicated	do	North Carolina Commission found that $142,000 was improperly accounted for in corporate books and records.	do	Not indicated	Not indicated.
Standard Oil of Indiana [2]	2, 016, 710	Form 8–K announcing results of investigation.	Probable illegal State contribution of $10,000 in 1970.	$10,000 payment in 1970 to trade association for political contributions. Aggregate of $289,000 in promotional allowances from supplies not recorded as assets.	From 1970–73, $617,000 in Italy. From 1970–75, $35,700 in Canada. The contributions were legal in these comtries during the periods in question.	See "payments to foreign officials".	Indications that consultant paid some of his fees for expenses of government officials. Also, from 1970 to 1975, the company paid travel assistance to government personnel and their families in aggregate cost of $86,000.	Tax consultant paid $386,000 from 1970–75. Retained consultant to obtain exploration and production rights paid $218,000. Sales price increases to accommodate customers in 1974 in total amount of $16,700.	Off-book-fund totaling $333,000 since 1970. When closed, money transferred in technical violation of foreign exchange laws. Some political contributions were recorded as advertising expenses, etc.	Some of the payments were improperly deducted for U.S. tax purposes.	Yes	Yes. Policy statement adopted.
Stanley Home Products Inc	164, 521	Report of investigation on form 8–K.	None	None	None	Not indicated	Payment of $50,000 to consultants who may have passed most or a portion of that sum to minor government officials.	Compensation of employees in a manner designed to avoid foreign taxes.	2 off-book accounts maintained by a foreign subsidiary totaling $80,000.	No liability	Payments appear to have been authorized by 1 or more officers/directors of the company.	Yes. Cessation will have no material adverse effect.
Sterling Drug	899, 787	Form 8–K announcing results of investigation covering 5 yrs.	No illegal contributions	Not indicated	No illegal contributions	Company made payments from $103,000 to $180,000 from 1970–75 related to sales of $1,960,000 to $4,300,000 to agencies that were affiliated with governments.	Payments of $33,000 to $252,000 in various years to obtain price increases, product registrations, and work, construction, and port permits.	Not indicated	Recorded as ordinary business expenses and description did not indicate true nature. Also, off-book funds reported.	Amended returns filed for 1970–74.	Management of foreign subsidiaries knew. One member of board of directors also knew of the payments.	Yes. Termination will have no material effect.
Sybron Corp	495, 093	Form 8–K announcing results of investigation.	Not indicated	do	Not indicated	Not indicated	Parments to government employees acting as purchasing agents or engineers of $76,500 in 1974–1975, related to sales of $1,900,000.	do	Recorded on books	None	No	Planning to propose policy statement.
Tenneco Inc	5, 001, 470	do	Funds established to receive voluntary employee contributions to be used in accordance with applicable law. Subsidiaries made lawful contributions of $180,000 in California. Some $3,000 contributed illegally by subsidiary in Louisiana.	Payments of $2,000 a month to Louisiana sheriff presently under investigation. Various payments of $200 to $2,000 may have been made to State utility commissioners, but employee who provided information now states that he was in error. Contribution to U.S. Senator which 2 employees report as having been paid to obtain influence in General Services Administration decision.	do	Payments to consultants outside consultant's domicile.	$10,000 to government employee. $25,000 invested in domestic concern in which foreign government employees probably had a beneficial interest. Merchandise valued at $480 given to employees of government purchasing agency.	$500,000 to military personnel. $330,000 for scholarship payments pursuant to contractual arrangements. Company also withholds all or part of foreign dealers' commission, on request, and pays to designated foreign banks.	Some payments improperly described on books and records.	Information to be turned over to IRS.	Knowledge of some of the payments.	Company is developing a policy to assure cessation.
UOP Inc	615, 046	do	None	Not indicated	None	Not indicated	Transfers to administrative personnel equivalent to $50,000 related to sales of $1,200,000 annually. Payments in similar amounts for 5 yr. Similar payment to higher level official in 1973 of $40,000.	Not indicated	Payments not supported by adequate documentation.	None	Representative of management was (informed in 1973).	Yes.

Company	Total revenues fiscal year 1974 (thousands)	Type of statement	Domestic political contributions	Other domestic matters	Foreign political contributions	Foreign sales type commissions	Payments to foreign officials	Other foreign matters	Books and records treatment	U.S. tax liability	Knowledge of top management	Cessation
United Brands	2,841,850	Form 8–K, form 8 and proxy statement.	Not indicated	Not indicated	Not indicated	Not indicated	Payment of $1,250,000 to Honduran official in connection with question import taxes. It was understood that a 2d $1,250,000 payment was to be made, but the company has decided not to make the payment.	Investigation of other foreign payments of $750,000.	Yes.	Not indicated.	Yes.	Not indicated.
United Technologies	(1)	Form 8–K reporting results of investigation.	No illegal contributions	No violations of U.S. laws	No illegal contributions	In 1974–1975 payments of $1,800,000 in commissions and fees, part of which may have been paid to independent representatives for the benefit of foreign government officials or employees. Also, the payment of $150,000 to representative who was also a consultant to a foreign corporation that might be considered a government instrumentality.	Company has discovered that subsidiary paid $50,000 to foreign government employees in violation of foreign law and believes that other payments were made over the last 5 years. In 1973, the corporation paid $40,000 to a high administrative official in same foreign country.	Not indicated	Inadequate documentation of certain payments.	None	Representative of top management was informed of the $40,000 payment.	Yes. Policy restatement issued. Cessation will have no material adverse effect.
The Upjohn Co	805,744	do	None	Not indicated	None	Some payments made to government employees or to 3d parties who paid government employees.	Payments of $2,710,000 made to officials of government agencies or instrumentalities to secure sales of $27,060,000. $26,000 for other government actions, including expenditing payments.	do	Not indicated	The IRS has been advised of the company's investigation. No improper deductions were taken for 1975.	No outside director knew of payments, but inside directors either knew of the payments or actually approved them.	Yes. Policy statement adopted. Cessation will have no material adverse effect.
Warner-Lambert Co	1,946,063	do	do	do	From 1971–75, contributions of $15,300. The local managers were advised that the contributions were legal.	Commission payments to Government employees totaling $1,664,100 from 1971–75.	Payments from 1971–75 from $18,300 to $221,200 including expediting payments. Payments for 5-year period that totaled $576,000.		Bank account not on books was used to pay commissions on Government sales in some cases. Other commissions booked as marketing expenses.	Erroneous deductions. For years 1970–73. Additional taxes of $325,839 were paid.	1 former member of senior management was aware of the payments, but none of the present members were aware.	Yes. Policy statement adopted.
Westinghouse Electric Corp	5,838,118	do	Not indicated	do	Not indicated	Company paid some $150,000 in excess of normal rate. Also, other payments not consistent with normal procedure were disclosed, as well as payment of a large consultant's fee.	Payments of $2,000 per year made to tax auditor from 1971–75. Also, payments of $58,000 in 2 yrs to sales company designated by employee of Government-owned corporation. Some $5,000 per year to Government official.		Foreign subsidiary maintained off-book accounts to make certain legitimate payments of some $59,000 per year. 1 subsidiary had inactive $3,000 off-book account. 1 other former subsidiary maintained a small off-book account.	Tax adjustments will be made where appropriate.	Neither management nor board of directors were aware of the activities.	Yes. Policy statement adopted. Cessation will have no material adverse effect.
White Consolidated Industries	1,016,621	Form S–14 reporting results of investigation.	None	do	None	Payments to agents in 1974 and 1975 of approximately $878,000; including gratuities of $10,000 related to sales of $50,000,000. $302,000 paid for special services.	Gratuities and gifts to Government officials of $10,000. Not know whether part of commission payments went to government officials.	Not indicated	No off-book records. Payments were recorded as having ordinary expenses or as having been made for services rendered. In some cases, documentation was not complete.	Investigation indicates that no questionable deductions were claimed for 1975.	Officers of the subsidary knew of the payments, as did 2 members of the board of directors; none were aware of their questionable nature, however.	Do.
Whitaker Corp.	778,246	Form 8 amendment to 8–K reporting results of investigation.	Contributions totaling $585 to congressional candidates by mid-level employees of the company from 1970 to 1975.	From 1970–75 a total of $47 328 paid to a customer in connection with sales in circumstances making it unclear whether the payments were legal.	Not indicated	Sums recorded as sales commissions used for other purposes. See "other foreign."	Not indicated, but see "other foreign."	$7,424.89 in 1970–71 to purchasing agent and management unaware. From 1970–75 some $126,000 were paid to employees as commissions to avoid foreign income.	Described as reimbursable expense. Company also acquired a subsidiary that had an off-book fund with total cash flow of $300,000 that was liquidated in 1975.	Company indicates that it will file amended tax returns where appropriate.	Company's senior vice president was aware of payments made to avoid employee taxes and other similar employee matters of the subsidiary.	Yes, reaffirmed policy.

[1] Negative revenues.
[2] Company indicates that the aggregate of all payments was $265,000.

The following is a summary of the six reports prepared and filed with the United States District Courts and the Commission pursuant to settlements of Commission actions against the corporations. Each of the reports was required to be attached as an exhibit to the company's Current Report on Form 8-K. In view of the significantly greater degree of detail in these reports in comparison to most other disclosures, these reports have been summarized separately.

These summaries present a general view of the matters set forth in the reports. They are not intended to be inclusive. Moreover, in view of the limitations inherent in summarizing such a significant body of information, the Commission strongly urges that persons interested in the conduct of particular corporations contained in this exhibit consult the actual reports themselves.

Also contained in this exhibit is a description of the facts alleged in eight other cases, the most recent of which was filed on May 10, 1976. In all of these cases, the corporate defendants consented to permanent injunctions against violations of the federal securities laws without admitting or denying the allegations set forth in the Commission's complaint and described herein. */ The factual allegations described in this portion of exhibit should be read with that limitation in mind.

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*/ On case, Securities and Exchange Commission v. Kalvex, CCH Fed. Sec. L. Rptr. ¶ 95,226 (July 7, 1975), was litigated by one of the individual defendants.

AMERICAN SHIP BUILDING COMPANY

The report, compiled by a special review committee comprised of two outside directors and an independent chairman, was filed on April 25, 1975, pursuant to the terms of a judgment and order entered against the American Ship Building Company. It generally indicated the following:

Domestic Political Contributions: The report indicates that selected employees were paid bonuses of $30,000 in 1970, $25,000 in 1971 and $42,325.17 in 1972. After receiving these bonuses and paying taxes thereon, the selected employees would be directed to contribute the remainder to various political figures. The Review Committee decided that the $42,325.17 bonus paid by the company to the nine selected employees in 1972 was a questionable expenditure and should be repaid to the company by its principal officer.

Other Domestic Payments: The report did not indicate whether other domestic payments were paid from corporate funds.

Foreign Political Contributions: The report did not state whether foreign political contributions were made from corporate funds.

Questionable Foreign Sales-type Commissions: The report did not indicate whether questionable foreign sales-type commissions were paid from corporate funds.

Payments to Foreign Officials: The report did not indicate whether payments to foreign officials were made.

Other Foreign Payments: The report did not indicate whether other foreign payments were made from corporate funds.

Books and Records Problems: The questionable bonuses discussed above were recorded as bonuses on the company's books and records. If the contributions made from them should be deemed to have been made by the company, recording them in this manner would be questionable. The reports did not indicate whether other possible books and records problems existed.

U.S. Tax Liabilities: The report did not indicate whether problems exist regarding the company's U.S. tax liabilities.

Management Knowledge: The report indicates that the company's top management was aware of the bonus program and that it was established to distribute funds to various political organizations. Key management officials were involved in the program.

Cessation: The report indicates that the company apparently terminated the bonus program after it was disclosed to the Watergate Committee. The report neither indicates nor recommends future company policy changes or other measures to assure that there will be no repetition of such questionable payments.

ASHLAND OIL INC.

The report was filed pursuant to the terms of a judgment and undertaking entered on May 16, 1975, against Ashland and some of its principal officers. It was prepared by a special review committee comprised of outside directors of the company. The special committee retained independent counsel and independent accountants to assist in the investigation and in preparation of the report. Neither the counsel nor the accountants were Ashland's regular outside counsel or auditors. The report, dated June 26, 1975, was filed with the Commission and the U.S. District Court for the District of Columbia on July 7, 1975. It revealed the following:

Domestic Political Contributions: The report disclosed that Ashland made domestic political contributions from corporate funds totalling nearly $850,000 during the period 1967 to 1972. The report indicated that a total of $25,700 expended from 1972-1974 constituted legal contributions. The following sums were reported but not identified as legal, however: 1967 - $66,500; 1968 - $239,600; 1969 - $46,300; 1970 - $71,700; 1971 - $54,500; 1972 - $256,815. In addition, the report indicated that $71,700 was "presumed to have been used" for political contributions during the 1967-1972 period.

Other Domestic Payments: The report indicated that $15,000 was paid by a subsidiary of the company in 1970 in response to an extortionate demand by a local government official. Federal criminal charges subsequently were brought in connection with this payment.

Foreign Political Contributions: The report indicated that Ashland Oil Canada, Ltd. (approximately 85% owned by Ashland Oil, Inc.) made political contributions of corporate funds in connection with federal and provincial elections in Canada. From September 1970 through September 1974 the total amount expended for such purposes was approximately $125,000. The report indicates that the Chairman and Chief Executive of Ashland-Canada advised the Special Committee that, in his opinion, such payments were not prohibited by applicable laws.

Payments to Foreign Officials: The company paid $202,000 to officials in a foreign country in conection with the acquisition of petroleum rights and the transfer of operating permits. The report also stated that in 1967 and 1968 the company made payments totalling approximately $50,000 to a group of individuals who were to provide "consulting services" to assist the company in the initiation of a refinery project in another country. This group included officials of that country.

The report states that in 1969, Ashland's Chief Executive Officer personally delivered $7,500 to an official of a third foreign country. The report further states that the company expended $2,500 of corporate monies on behalf of another official of that country, and that all or part of a $100,000 payment by the company to a consultant in that country may have been paid by the consultant to another official of the national petroleum company of that country.

Other Foreign Payments: In connection with Ashland's attempts in the late 1960's to secure business opportunities in a foreign country, the company made substantial payments to various consultants. Thirty thousand dollars of the amounts paid to a particular consultant were not satisfactorily corroborated by the special committee. The committee was unable to determine to its satisfaction that such amounts were received by him and were not used for political or illegal purposes in the United States or overseas.

Additional payments and transactions, totalling $162,500 during the period 1967-1970, were identified as having been effected with virtually no written documentation or with inadequate supporting documentation. In almost every case, they involved overseas cash disbursements to senior officers of the company.

Books and Records Problems: Most, if not all, of the transactions generating funds for domestic payments were improperly reflected on Ashland's books and records. Cash was generated for the fund principally by overseas wire transfers from company accounts at domestic banks to overseas correspondent banks. The funds would then be withdrawn by a senior corporate officer and secretly returned to corporate headquarters in the United States. False entries (e.g., "intercompany advances--exploration/production") were made in the company's books and records to cover such transfers and disbursements.

U.S. Tax Liabilities: As a result of the improper entries on the company's books and records, improper deductions totalling at least $429,997 were taken by Ashland in connection with its United States taxes. At the time of the report, the company had entered into a settlement with the IRS as to certain years in question, and it was understood that the IRS was continuing to review the tax returns for the remaining years.

Management Knowledge: The great majority of domestic payments were made by means of an off-books cash fund kept in an officer's safe at corporate headquarters. Senior management of the company, including the Chairman and Chief Executive Officer, Vice-Chairman and Chief Administrative Officer, as well as a number of other senior officers, were not only aware of but were actively involved in the operation of the fund and participated in the diversion of corporate monies to the fund and in making disbursements therefrom. (A total of more than $800,000 in cash was funneled through this fund over a seven year period.) There is also evidence that certain former principal officers of the corporation may have made contributions from corporate funds in addition to those specifically identified in the report. Senior officers of the company were directly involved in and aware of most of the foreign payments identified above.

Cessation: The report contained numerous recommendations by the special committee with respect to the cessation of the practices described in the report and establishment of new controls over certain business activities and practices. Recommendations also were made regarding certain matters of corporate structure. The principal recommendations, with the action taken by the Board in response thereto shown in parenthesis, are as follows:

(1) No political contributions should be made by the corporation, whether lawful or not. (Adopted, except for political contributions which are legal under a foreign country's laws)

(2) Adoption of a policy and appropriate implementing procedures against the use of corporate assets for any purpose illegal under the law of the jurisdiction where the transaction occurs. (Adopted with specific recommended procedures to be developed and submitted for further Board consideration)

(3) A policy against the maintenance of undisclosed funds or unaccounted for expenditures. (Adopted)

(4) Establishment of additional controls over cash disbursements, for example, all disbursements from corporate accounts to be made only by check payable to the ultimate payee; no bearer checks or checks payable to cash. (Specific control proposals referred to Audit Committee)

(5) Various recommendations regarding strengthening of the corporation's Internal Audit Department, revising controls over corporate bank accounts and borrowing, controls over the use of corporate aircraft, etc. (Executive Committee to review and report to Board)

(6) Establishment of control procedures with respect to arrangements with consultants, such as requiring senior officer or Board approval for various levels of expenditures and requiring an attestation by the consultant that he will not return any funds to officers or employees of the corporation and will not make illegal payments to third parties. (No action)

(7) Change in composition of the Board of Directors to a maximum of 15, with a majority to be neither officers not employees of the corporation (the board then existing was composed of 17 directors, of which 10 were "insiders.") (Referred to Directors Committee for subsequent report to the Board)

(8) Changes in the Executive, Audit and Nominating Committees of the Board of Directors to increase the proportion of outside Directors on each. (Referred to Directors Committee for subsequent report to the Board).

GULF OIL CORPORATION

The Gulf Oil report was compiled by a special review committee comprised of two of the outside directors of Gulf and the chairman of the committee, who was completely independent. The committee retained outside accountants and counsel to assist in its investigation. The report was filed on December 30, 1975. It disclosed the following:

Domestic Political Contributions: The report disclosed specific domestic political contributions (including gifts and related expenses) from corporate funds totalling approximately $1.4 million from 1960-1972. The report further disclosed that during the period Gulf had approximately $5.4 million returned to the United States from foreign countries in off-books transactions to be used for political contributions, gifts and related expenses. The Committee was unable to determine the disposition of over $4 million of this total.

Other Domestic Payments: The report does not indicate whether other domestic payments were made from corporate funds.

Foreign Political Contributions: The report indicates that the company made foreign political contributions in seven countries totalling approximately $6.9 million during the period 1960-1973. In some of these countries the payments were legal; in others they apparently were not. With respect to those contributions that the committee was able to trace, the report identifies the recipients and discusses the circumstances involved.

Questionable Foreign Sales-Type Commissions: The committee did not find any unusual or excessive commissions. However, it recommended that the Board of Directors institute a review of all commissions and consultants fees.

Payments to Foreign Officials: The report treated all payments to foreign officials as foreign political contributions, discussed above.

Other Foreign Payments: The reports indicated that the Committee investigated leads in approximately eleven foreign countries which proved fruitless.

Books and Records Problems: The report described the use of a subsidiary in the Bahamas to launder approximately $10 million for both foreign and domestic use. The company would disburse approximately $500,000 a year to the subsidiary, which would be capitalized as operating expenses of the subsidiary. Every few weeks, approximately $25,000 would be brought back to the United States to create an off-books fund for domestic purposes. The report also discusses the false accounting used in connection with approximately $2.3 million used for foreign contributions.

U.S. Tax Liability: The IRS is investigating to determine whether the company has additional tax liabilities.

Management Knowledge: The report concluded that certain past top officials of the company knew of the questionable and illegal activities and that others currently in the company's management should have known of the activities. A past Chairman of the company and two past Executive Vice-Presidents resigned as a result of these activities and the Secretary was removed from that position and given a position in the company's legal department. Additionally, one director found to be involved did not run for re-election.

Cessation: The report concluded that Gulf's questionable activities have been effectively terminated. The report discussed the changes in corporate policy on which it based its belief, including:

(1) A statement in the Policy Manual that illegal contributions of corporate funds are prohibited and activities in this area must be reported to the Chief Executive Officer and the Board;

(2) A requirement that approval of retainer and consulting agreements exceeding certain amounts must be obtained at a high level of management;

(3) Establishment of a policy of compliance with all laws and regulations of all countries where Gulf operates;

(4) Institution of tighter control over bank accounts; and

(5) The requirement of annual representation letters from certain executives and employees.

The report also indicated certain accounting procedures had been changed in an effort to prevent such activities and recommended certain other changes to the Company.

MINNESOTA MINING AND MANUFACTURING COMPANY

The report of the Minnesota Mining and Manufacturing Company ("3M) was prepared by a special agent, Judge William P. Murphy, a retired Associate Justice on the Minnesota Supreme Court, upon completion of an investigation which was conducted pursuant to a judgment and undertaking entered against the company. It was filed with the Company's Form 8-K for the month of November, 1975. Generally, it reveals:

Domestic Political Contributions: Between 1963 and 1969, a total of $633,997 of 3M corporate funds was misappropriated and placed in a secret fund to be used for domestic corporate political contributions. Of that amount, $545,799 ultimately was used for domestic corporate political contributions from 1963 to and including 1972. Although some contributions were made in states where such corporate contributions were legal, the vast majority of this amount was illegally contributed.

The assets of the secret fund were generated through fictitious foreign insurance premiums issued from 1963-1967, and through kickbacks by a foreign legal consultant from 1967-1969.

Other Domestic Payments: The report indicated that no other corporate domestic payments were discovered.

Foreign Political Contributions: The report indicated that no corporate foreign political contributions were discovered.

Questionable Foreign Sales-type Commissions: The report indicated that no other corporate foreign sales-type commissions were discovered.

Payments to Foreign Officials: The investigation revealed that in 1975 a payment of $52,000 was made by the Managing Director of a 3M foreign subsidiary to a foreign customs official to avoid liabilities and penalties arising from an alleged evasion of customs payments. Because such payment was unauthorized and contrary to 3M policy the individual was relieved of his duties, assigned to another position with 3M, and required to execute notes in the amount

of $52,000 to 3M. The report did not disclose the identity of the foreign country, foreign subsidiary, or managing director in light of the small size of the subsidiary, which accounted for less than one percent of the consolidated sales and profits, and 3M's claim that such disclosure would imperil the company's investment, expose its property to expropriation, or result in costly harassment.

Other Foreign Payments: The report indicated that no other foreign corporate payments were discovered.

Books and Records Problem: The assets of the secret fund used to make domestic political contributions were falsely recorded on the books and records of 3M as foreign insurance premium expenses from 1963-1967 and as foreign legal expenses from 1967 through 1969.

U.S. Tax Liability: Because all of the sums placed in the secret fund were recorded as insurance and legal expenses and deducted in computing federal income tax, the computations on its tax return were in error. At last report, two of the individuals responsible for the political contribution schemes were under federal indictment as a result of the filings.

Management Knowledge: The President and Vice-President of Finance actively participated in the activities connected with the political contributions, as did the company's Director for Civic Affairs. Subsequently, another President also authorized disbursements from the secret fund, but did not participate in its replenishment.

Cessation. Domestic political contributions were not made after 1972, at which time the then President became aware that they were illegal. On August 16, 1972, the President caused 3M voluntarily to contact the Special Prosecutor's Office to inform it of the fund's existence and use. Subsequently, 3M and the President both pled guilty to violations of the Corrupt Practices Act and fines were imposed on both.

As a direct consequence of these unlawful corporate political contributions and the resulting criminal convictions and civil injunctions, three officers resigned. Another was to retire in 1976.

Other than a statement within the report that 3M had accepted the above resignations and has taken steps to minimize the possibility of a recurrence of a similar event, no other steps to minimize the possibility of a recurrence are reported. The report mentioned that the Audit Committee made up of "outsiders" is a significant deterrent to similar future activities.

PHILLIPS PETROLEUM COMPANY

The report, filed pursuant to a judgment and order entered against Phillips Petroleum Company as part of a settlement on March 6, 1975, was based on an investigation conducted by outside counsel. One of the partners of the firm retained to conduct the investigation was an outside director of the Company. The report was dated September 26, 1975. It indicated:

Domestic Political Contributions: The report disclosed that Phillips made domestic political contributions from corporate funds totalling approximately $585,000 from 1964 through 1972. The contributions included $215,000 contributed in conjunction with state elections; $70,000 contributed to various candidates in conjunction with political dinners; $125,000 contributed to Congressional candidates; and $175,000 contributed to Presidential candidates. The report did not attempt to distinguish between illegal and legal contributions.

Other Domestic Payments: The report did not indicate whether other domestic payments were made from corporate funds.

Foreign Political Contributions: The report did not indicate whether foreign political contributions were made from corporate funds.

Questionable Foreign Sales-type Commissions: The report did not indicate whether questionable foreign sales-type commissions were paid from corporate funds.

Payments to Foreign Officials: The report did not indicate whether payments to foreign officials were made from corporate funds.

Other Foreign Payments: The report indicated that $1,258,000 of off-books cash was paid to two foreign individuals involved in a construction project by Phillips in a foreign country. The report indicates that this payment, which was not properly entered in Phillips' books and records, was for services rendered to Phillips in connection with the project and was made secretly to enable the two individuals to avoid income taxes by their country.

Books and Records Problem: Beginning in 1963, Phillips disbursed over $2.8 million of corporate funds to two Swiss accounts. These disbursements were made by means of false and fictitious entries on its books and records. $2.1 million of the total was represented as an overpayment on a contract. The balance of the fund was generated by means of a secret discount which Phillips received in conjunction with a transportation contract. Neither of these rebates were reflected on Phillips' books and records.

U.S. Tax Liability: The $2.8 million in the slush fund discussed above was not reported as income by Phillips. Subsequently, it has been so reported. Evidently, Phillips did not claim any deductions for the payments it made. The IRS is investigating the company's tax returns.

Management Knowledge: The chief executive officers of Phillips in 1963 and 1964 were responsible for originating the fund. The subsequent chief executive officers were aware of and controlled the fund. The report indicates that few others in the company knew of the fund.

Cessation: Since Phillips' consent to the entry of permanent injunction, the company has issued a directive to the heads of staff under the signatures of the Chairman and President, prohibiting the creation and maintenance of secret or unrecorded funds of assets and the recording of false and fictitious entries in books and records of the company, and reiterating the company policy against the use of corporate funds for unlawful purposes.

Also, the company's board has acted to carry out the requirement of the judgment that it monitor the activities of the company on a continuing basis to prevent recurrence of the offenses which had been the subject of action. By a

resolution adopted on June 9, 1975, the board recited the terms of the final judgment of permanent injunction and undertaking and assigned extensive new responsibilities in connection therewith to the audit committee. Pursuant to that resolution, the audit committee is engaged in establishing, in consultation with the company's outside auditors and comptroller, reporting and auditing procedures designed to ensure the observation of the terms of the final judgment.

NORTHROP CORPORATION

The report was filed pursuant to the terms of a judgement and undertaking entered April 17, 1975, against Northrop and certain of its principal officers. It was compiled by the outside directors of Northrop's Executive Committee. The Committee retained independent accountants and independent counsel to investigate and report on the nature and extent of corporate misconduct. The report, dated July 16, 1975, was filed with the Commission and the United States District Court for the District of Columbia, on July 17, 1975. In general terms, it revealed:

Domestic Political Contributions: The report disclosed that Northrop made domestic political contributions from corporate funds totalling at least $501,928 during the period 1962 to 1973. This total includes $150,000 specifically identified as having been illegally contributed to the 1972 Nixon re-election campaign. Moreover, the majority of all contributions were effected by means of falsely recorded transactions from an off-books fund of cash.

Other Domestic Payments: The report indicates that Northrop's Eastern Regional Office (located in Washington, D.C.) engaged in improper practices involving the extensive use of cash and improper accounting for funds that the report described as "in effect, a hidden fund of cash." A total of $119,000 was disbursed in numerous cash transactions by that office from 1971 to 1973. While the Committee did not specifically conclude that violations of law had, in fact, taken place, the report indicated that such expenditures were predominantly made in connection with the company's efforts to extend "corporate hospitality" to government officials and that the "acceptence of such hospitality by the officials involved appears to have been questionable." The report also indicated that $40,000 paid to a Northrop consultant was used to pay the retired Chief Counsel of a House Committee for "consulting services."

Foreign Political Contributions: While the report indicated that Northrop made very substantial overseas expeditures, none were specifically identified as having been made as foreign political contributions.

Questionable Foreign Sales-type Commissions: The report details the Committee's investigation into nineteen specific transactions or arrangements identified by the independent auditors as requiring further investigation. Most of these involved overseas agency and commission arrangements. In all, the company paid approximately $30 million to foreign consultants and sales agents, a significant portion of which was found to have been inadequately accounted for, lacking in documentary support or incapable of satisfactory corroboration.

Payments to Foreign Officials: The report identified a total of at least $454,400 as having been specifically paid to foreign officials, and indicated that such payments "raised serious questions as to possible violations of law." Of this amount, payments aggregating $450,000 were made to a foreign agent of the company with the knowledge that these funds were to be paid to two foreign officials. The remaining $4,400 was paid directly to an official of another country, in an apparently unlawful effort to settle a tax liability. In addition, it is evident from the report that substantial amounts of money paid by Northrop as commission fees were paid to individuals or organizations having principals who were then foreign government officials or who were or had been closely associated with foreign officials. For example, a foreign official was a principal in a foreign corporation which Northrop used as a marketing agent in connection with foreign sales. The company received an initial advance from Northrop of $250,000 and currently has claims against Northrop for $7-8 million.

Other Foreign Payments: Subsequent to the report, the company disclosed that approximately $861,301 had been paid by one of its subsidiaries during the period 1969 to 1975 to recipients in several foreign countries. The company indicated that such payments "may have been in violation of applicable laws." The company further indicated that these amounts were paid by the subsidiary's managing director without Northrop's knowledge. Approximately $129,000 of this amount was paid subsequent to the entry of the judgment against Northrop in the Commission's injunctive action.

Books and Records Problem: An unrecorded "slush fund" was utilized by top management of Northrop as a principal means of funding political payments. The fund was derived from payments, totalling $1.15 million over a 12 1/2 year period,

to a foreign consultant retained by Northrop. Approximately one-third of the amount paid to the consultant ($376,000) was returned in cash to a senior Northrop official who maintained the secret fund. The total of the $1.15 million paid to the foreign consultant was inaccurately reflected on Northrop's books and tax returns as consultants' payments. The practices of Northrop's Eastern Regional Office involved currency transactions totalling $119,000 which were effected by means of improper accounting practices. The payments to two foreign officials by an agent of the company were deducted by the company as "ordinary and necessary business expenses" on Northrop's 1973 tax return, resulting in an inaccurate statement of income. The company's treatment of such payments also resulted in an inaccurate submission of cost figures to the Department of Defense. In addition substantial amounts of Northrop's other foreign commission payments were effected by means of improper or inadequate accounting practices, and frequently were totally lacking in any appropriate documentation.

U.S. Tax Liability: Many of the payments and transactions may have involved substantial omissions and misstatements by the company of various items in its U.S. tax returns. The IRS has been conducting an investigation into the matters disclosed in the report and related matters.

Management Knowledge: The Chairman of the Board of Directors of Northrop, who also was President and Chief Executive Officer; and a former Vice-President and director, personally maintained the unrecorded cash fund and made political payments therefrom. The same former Vice President received the cash rebated by the foreign consultant for diversion to the fund. While both have maintained that they were the only officers, directors or employees specifically aware of or responsible for the creation and use of the secret fund, various other senior company officials knew of or participated in the consulting, commission and other arrangements detailed in the report. In addition, the report included information confirming that the Chairman of the Board submitted falsified documents to federal investigators in connection with the Nixon contribution investigation, and that all four officer-directors involved in the transactions had given false statements to federal investigators.

Cessation: The report contained various recommendations with respect to correcting the improprieties revealed by the investigation, including the following:

(1) Board approval should be required on all consultants' or agents' agreements above specified dollar amounts, with a requirement of written approval by senior management of all significant consultants' or agents' relationships.

(2) The adoption of specific procedural requirements to assure that information is obtained regarding proposed consultants' or agents' agreements to insure their propriety and to enable informed management decisions prior to entering into such agreements.

(3) The adoption of specific requirements to be incorporated into all consultants' or agents' agreements, including a covenant by each consultant or agent that he will comply with all applicable laws, that periodic reports concerning his activities will be furnished to the company, and that he will enter into no undisclosed relationships.

(4) The adoption of a policy prohibiting retention of a government official as a representative of the company absent a clearly legal basis for doing so under applicable laws and unless prior Board approval has been obtained.

(5) Recommendation of policies regarding other corporate matters, including the formalization of procedures to insure against violation of conflict of interest laws, against improprieties in providing corporate hospitality to government officials, and to assure compliance with federal procurement regulations.

(6) Identification of certain institutional shortcomings as subjects for Board action to correct a corporate atmosphere which permitted the practices discussed.

(7) Adoption of a new policy requiring periodic changes in the company's outside auditors as an added safeguard in the audit process. The company had had the same independent auditors for over 35 years. The Committee did not find any breach of duty by the auditor in fulfilling its responsibility to conduct its audits in accord with appropriate standards.

The following is a description of the facts set forth in the Commission's complaints in cases that have not yet resulted, or in one case will not result, in the production of reports similar to those previously analyzed.

Braniff Airways, Inc:

The complaint, naming Braniff Airways, Inc., Braniff International Corporation and three officers of Braniff Airways as defendants, charged the maintenance of a secret fund of corporate assets in excess of $900,000, which was used in connection with an illegal political contribution and secret payments to travel agents in Latin America in contravention of the Federal Aviation Act, foreign law and International Air Transport Association resolutions. Among other things, it was also alleged that certain of the defendants disbursed $40,000 in corporate funds to a Panama corporation closely held by a regional vice president of Braniff Airways as an alleged bona fide expense, when in fact this payment was a vehicle for conversion of corporate assets into cash to be used for unlawful political purposes.

General Tire & Rubber Corporation:

The Commission alleged that a "slush fund" had been established by General Tire and its subsidiaries in order to obtain favorable treatment by certain foreign governments. In addition, the complaint alleged that through purported salary increases and bonuses corporate funds were diverted for political purposes. In the aggregate, several million dollars were used for these and similar undisclosed corporate activities. The allegations are described in more detail at pages 5-6 of this report.

Kalvex, Inc:

The Commission charged defalcations of corporate assets by senior officers who allegedly submitted duplicate expense vouchers and received kickbacks that were not reported to the company. Following litigation, an order of permanent injunction was entered.

Lockheed Aircraft Corporation:

The Commission complaint named Lockheed, the Chairman of the Board of Directors from 1967 until February, 1976, and the President of the company from 1967 until October, 1975. In particular, the Commission alleged that secret payments of at least $25 million (at times in cash) had been made to foreign government officials for the purpose of assisting Lockheed in procuring and maintaining contracts with foreign government customers, and in expediting permits necessary to perform existing contracts. Among other things, it was alleged that the defendants disguised these secret payments on Lockheed's books and records by utilizing, or causing to be utilized, false accounting entries, cash and "bearer" drafts payable directly to foreign government officials, nominees and conduits for payments to government officials and other artifices and schemes. As a result of their activities, at least $750,000 was not expended for the purpose indicated on the books and records of Lockheed and its subsidiaries and was deposited instead in a secret Swiss bank account, and an additional $25 million was expended in secret payments to foreign officials. In addition, the Commission alleged that over $200 million was disbursed to consultants and commission agents without adequate records and controls to insure that the services actually were rendered. The practices were alleged to have resulted in the filing of inaccurate financial statements with the Commission with respect to the income, cost and expenses of the company.

Missouri Public Service Company:

The Commission alleged that the defendants utilized corporate money for illegal political purposes. In particular, the Commission alleged that corporate funds were diverted by means of certain employees' secret agreement to contribute a percentage of their monthly salaries to a nonprofit club, which would in turn make the contributions. In excess of $67,000 was alleged to have been diverted from the company's system of accountability.

Sanitas Service Corporation:

The Commission alleged that the defendants caused Sanitas to enter into an agreement designed to disguise otherwise secret cash payments for illegal political purposes, bribes, kick-backs and other similar payments. Through this contractual relationship the defendants funneled in excess of $1.2 million out of the corporation's system of financial accountability, some indeterminate portion of which was converted by one of the defendants for his personal use. In order further to disguise and effectuate such payments, the defendants submitted fictitious invoices and authorized the payment of corporate assets to wholly-owned subsidiaries.

United Brands Company:

The Commission alleged that United Brands deposited $1.25 million in the Swiss bank accounts of designated foreign government officials and agreed to pay an additional $1.25 million at a later date, provided the company received certain preferential export tax considerations. (These matters are reported in substantially the same manner in United Brands filing that is analyzed in Exhibit A).

Waste Management, Inc:

The Commission alleged that a secret fund of approximately $36,000 was used by the defendants for political contributions and other purposes, some of which were illegal. The Commission further alleged that the corporation and the defendants failed to maintain adequate accountability such that its auditors were unable to verify disbursements.

Exhibit C

Proposed Statement on Auditing Standards: Illegal Acts by Client

EXPOSURE DRAFT

PROPOSED STATEMENT ON AUDITING STANDARDS: ILLEGAL ACTS BY CLIENTS

APRIL 30, 1976

Issued by the Auditing Standards Executive Committee of the American Institute of Certified Public Accountants For Comment From Persons Interested in Auditing and Reporting

Comments should be received by July 30, 1976, and addressed to Auditing Standards Division, File Ref. No. 3620 AICPA, 1211 Avenue of the Americas, New York, N.Y. 10036

AICPA

American Institute of Certified Public Accountants
1211 Avenue of the Americas New York, New York 10036 (212) 575-6200

April 30, 1976

To Practice Offices of CPA Firms; Members of Council; Technical Committee Chairmen; State Society and Chapter Presidents, Directors and Committee Chairmen; Organizations Concerned With Regulatory, Supervisory or Other Public Disclosure of Financial Activities; Persons Who Have Requested Copies:

An exposure draft of a proposed Statement on Auditing Standards entitled "Illegal Acts by Clients" accompanies this letter. The exposure period has been extended in recognition of the importance of this issue.

This proposed Statement does not contain specific procedures to detect an illegal act by a client. An examination in accordance with generally accepted auditing standards cannot be expected to provide assurance that illegal acts will be detected. This limitation is considered in another proposed Statement entitled "The Independent Auditor's Responsibility for the Detection of Errors and Irregularities" also issued for comment today.

The proposed Statement does specify that the auditor should be aware of the possibility that illegal acts may have occurred that may have a material effect on the financial statements. It further requires that should an auditor become aware of a possible illegal act he should perform additional procedures to investigate the matter and, if necessary, consult with legal counsel. The exposure draft also offers practical suggestions in connection with illegal acts that do not appear to have a material effect on the financial statements.

Comments and suggestions on any aspect of the enclosed draft are sought and will be appreciated. They should be addressed to the Auditing Standards Division, File Ref. No. 3620, at the AICPA in time to be received by July 30, 1976. The Auditing Standards Executive Committee will be particularly interested in the reasoning underlying comments and suggestions.

Sincerely,

John F. Mullarkey

John F. Mullarkey, Director
Auditing Standards Division

Kenneth P. Johnson

Kenneth P. Johnson, Chairman
Auditing Standards Division

PROPOSED STATEMENT ON AUDITING STANDARDS
ILLEGAL ACTS BY CLIENTS

1. This Statement provides guidance for an independent auditor when acts that appear to him to be illegal come to his attention during an examination of financial statements in accordance with generally accepted auditing standards. This Statement also discusses the extent of the attention he should give, when performing such an examination, to the possibility that such acts may have occurred. The types of acts encompassed by this Statement include illegal political contributions to a candidate in an election for a federal office, bribes, and other violations of laws and regulations.

2. This Statement sets forth guidelines for the appropriate conduct of an independent auditor in fulfilling his obligation to report on financial statements in accordance with professional standards (paragraphs 4-19). It also offers practical suggestions and guidance for the auditor in connection with illegal acts not having a material effect on the financial statements (paragraphs 20 and 21).

3. An examination made in accordance with generally accepted auditing standards cannot be expected to provide assurance that illegal acts will be detected.[1] In reporting on financial statements, the independent auditor holds himself out as one who is proficient in accounting and auditing. Determining whether an act is illegal is usually beyond the professional competence of an auditor. The auditor's training and experience, however, ordinarily should provide a reasonable basis for an awareness that some acts by a client coming to his attention in the performance of his examination might be illegal. Nevertheless, the further removed such an act is from the events and transactions ordinarily reflected specifically in financial statements, the less likely it is that the auditor may become aware of the act or recognize its possible illegality.

[1] See SAS No. XX, "The Independent Auditor's Responsibility for the Detection of Errors and Irregularities," paragraph 18; regarding the limitations of an examination in accordance with generally accepted auditing standards.

Procedures That May Identify Illegal Acts

4. The auditor's examination in accordance with generally accepted auditing standards does not ordinarily include procedures specifically designed to detect illegal acts. In making such an examination, however, the auditor should be aware of the possibility that illegal acts may have occurred that may have a material effect on the financial statements. If as a result of his procedures the auditor believes that illegal acts may have occurred, he should perform additional procedures to investigate those matters, including consultation with legal counsel as necessary, to obtain an understanding of the nature of the acts and their possible effects on the financial statements.

5. The auditor's examination contains procedures that are performed primarily for other purposes, but that may also bring possible illegal acts to his attention. Such procedures include evaluation of internal control and related tests of transactions and balances (paragraphs 6-8), and inquiries of management and others (paragraphs 9 and 10).

6. *Evaluation of Internal Control and Related Tests of Transactions and Balances.* The auditor's interest in internal accounting control relates to the authorization, execution, and recording of transactions and accountability for the related assets (see SAS No. 1, sections 320.27-.40 and 320.43-.48). The auditor's review and tests of compliance with internal accounting control procedures and related substantive tests may bring to his attention unauthorized transactions; transactions improperly recorded as to amount, accounting period, or classification; or transactions not recorded in a complete or timely manner to maintain accountability for assets. Such transactions may raise questions about the possible existence of an illegal act.

7. In making an examination, the auditor obtains evidential matter as to the propriety of the accounting treatment of and support for transactions and balances. The procedures performed to obtain evidential matter include obtaining an understanding of the transactions tested and their business purpose. A transaction that appears to the auditor to have a very unusual or questionable purpose may raise questions about the possible existence of an illegal act.

8. In making an examination, the auditor ordinarily considers laws and regulations that have a direct monetary effect on the amounts presented in financial statements, knowledge of which is within the expertise of the auditor. For example, tax laws affect accruals and the amount recognized as an expense in the accounting period. Also, applicable laws or regulations may affect the amount of revenue accrued under government contracts.

9. *Inquiries of Management and Others.* The auditor's examination should include inquiries of the cli-

ent's management in connection with the accounting for, and disclosure of, loss contingencies and related communication with legal counsel. The auditor should also inquire about the client's compliance with laws and regulations and about the client's procedures relevant to the prevention or detection of illegal acts, such as policy directives issued by the client and periodic representations obtained by the client from management at appropriate levels of authority concerning compliance with laws and regulations. Possible illegal acts may come to the auditor's attention through such inquiries. For example, an auditor may learn of an investigation by a governmental agency or enforcement proceedings concerning violations of laws with respect to occupational health and safety, food and drug administration, securities, truth in lending, environmental protection, or price fixing or other anti-trust practices.

10. If no external evidence, such as a government agency investigation or an enforcement proceeding, comes to the auditor's attention or if there is no information from the client's management or legal counsel drawing his attention to such matters, the auditor's examination cannot reasonably be expected to detect the types of violations of laws and regulations that are indicated in paragraph 9. The laws and regulations governing hose matters are highly specialized and complex. Also, they normally relate to the operating aspects of an entity rather than its financial or accounting aspects. Consequently, determining compliance with such laws and regulations is outside the professional competence of independent auditors.

Evaluation of the Materiality of an Illegal Act

11. In evaluating the materiality of an illegal act coming to his attention, the auditor should consider the monetary effects, if any, on the financial statements of the transactions involved, including the related contingent monetary effects of the violation. Contingent monetary effects include fines, penalties, and damages. Other effects of a violation that also should be considered include loss contingencies that should be disclosed and other matters that should be disclosed in the financial statements (see paragraphs 13 and 14).

12. Loss contingencies, such as the threat of expropriation of assets, enforced discontinuance of operations in a foreign country, or possible litigation, may arise as a result of an illegal act. The auditor's considerations for evaluating the materiality of those loss contingencies are similar to those applicable to other loss contingencies.[2]

13. The auditor should also evaluate the adequacy of disclosure of the potential effect of an illegal act on the operations of the entity. If a significant amount of revenue or earnings is derived from transactions involving illegal acts, or if illegal acts create significant unusual risks associated with a material amount of revenue or earnings, such as the loss of a significant business relationship, that information ordinarily should be considered for disclosure in the financial statements.

14. In the case of certain illegal acts not having a material effect on the financial statements, there nevertheless may exist a material loss contingency requiring disclosure in the financial statements because of management's failure to make a required nonfinancial-statement disclosure. For example, nonfinancial-statement disclosure of certain illegal acts by management, such as conviction for illegal campaign contributions, may be necessary to comply with the requirements of a regulatory agency because of their alleged impact on the integrity of management, even though the amounts are not material to the financial statements.[3] Determining whether the client is required by applicable laws and regulations to make such disclosure ordinarily requires an opinion from legal counsel.

Actions by the Auditor Concerning a Possible Illegal Act

15. Because of the variety of acts and circumstances that might be encountered, it is not practicable to provide specific guidance on the steps an auditor should consider taking with respect to a possible illegal act that comes to his attention. The auditor should consider the circumstances promptly; such consideration may include seeking the advice of legal counsel or other specialists. The implications of a possible illegal act should be considered in relation to the intended degree of reliance to be placed on the internal accounting control and the representations of management.

16. After it has been determined that an illegal act has occurred, the auditor should report the circumstances to personnel in the client's organization at a high enough level of authority so that appropriate action can be taken with respect to—

(a) adjustments or disclosures that may be necessary in the financial statements;
(b) disclosures that may be required in other documents issued on a more timely basis; and
(c) consideration of appropriate remedial actions to be taken.

In some circumstances, the only appropriate persons of a sufficiently high level of authority to take necessary action in the organization may be the audit committee or the board of directors.

Illegal Acts Having a Material Effect

17. If the auditor concludes that an event whose effect, taken alone or with similar events, is material in amount and has not been properly accounted for or disclosed in the financial statements, he would ordinarily need to qualify his opinion or express an adverse opinion because of the departure from generally accepted accounting principles (see SAS No. 2, paragraphs 15-17).

18. The auditor may conclude that the effects of an illegal act on the financial statements are not susceptible of reasonable estimation. When it is reasonably possible, or probable, that a loss contingency arising from an illegal act will be resolved by a future event and the amount of the potential loss cannot be estimated, an uncertainty exists for which the auditor should consider the need to qualify his opinion (see SAS No. 2, paragraphs 21-25).

19. In some instances, the auditor may not be able to determine the amounts associated with an event, taken alone or with similar events, because of an inability to obtain sufficient competent evidential matter. For example, the act may have been accomplished by circumventing the internal control system and may not be properly recorded or otherwise adequately documented. In those circumstances, the auditor should consider the need to qualify his opinion or disclaim an opinion because of the scope limitation (see SAS No. 2, paragraphs 10-12).

Consideration of Other Illegal Acts

20. The auditor's consideration of illegal acts that come to his attention that do not have a material effect on the financial statements will normally be influenced by the nature of the act and management's actions once the matter is brought to its attention. If an illegal act has come to his attention and he cannot persuade the client's board of directors or its audit committee or other appropriate levels within the organization to give appropriate consideration to remedial action, the auditor should consider withdrawing from the current engagement or dissociating himself from any future relationship with the client. The auditor's decision as to whether to withdraw or dissociate because of an illegal act not having a material effect on the financial statements ordinarily will be affected by the following factors: (a) the effects on his ability to rely on management's representations and (b) the possible effects of continuing his association with the client, including the appearance of a loss of independence. In reaching a decision on withdrawal or dissociation, the auditor should consult with legal counsel.

Notification of Outside Parties

21. Deciding whether there is a need to notify outside parties of an illegal act is the responsibility of management. In the ordinary case, the auditor is under no legal obligation to notify outside parties. However, if the auditor considers the illegal act to be sufficiently serious to warrant withdrawing from the engagement, he should consult his legal counsel as to what other action, if any, he should take.

[2] Generally accepted accounting principles for the financial accounting for and reporting of loss contingencies are contained in Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies."

[3] For example, the SEC's Securities Act Release No. 5466 requires that "... the conviction of a corporation and/or its officers or directors for having made illegal campaign contributions ... should be disclosed to the public and specifically to the shareholders, particularly in the context of a proxy statement where shareholders are being asked to vote for management."

Exhibit D

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

OFFICE OF
THE CHAIRMAN

May 11, 1976

William Batten
New York Stock Exchange, Inc.
11 Wall Street
New York, N. Y. 10005

Dear Mil:

I want to take this opportunity to congratulate you again on your recent appointment and to wish you the best of luck. The job is a challenging one, but one I know you will fill with distinction. I speak for all the members of the Commission in saying that we look forward to working with you on the many complex problems facing the securities industry today. In that vein, I would like to advise you of a subject which Jim Needham and I have discussed informally in the past, and ask for the benefit of your thoughts.

As you know, the Commission has for many years advocated that publicly-held companies create audit committees, composed of independent directors, to work with outside auditors.*/ In our review of corporations who have revealed questionable foreign and domestic payments we have found an almost universal use of misleading financial records to conceal such corporate practices from outside auditors and directors and corporate counsel. The existence of an audit committee that meets privately with the outside auditors to discuss the scope of the audit, questions arising during the audit, including disputes with management, and that has access to the corporate financial information, is an important part of our effort to maintain the credibility of our system of corporate self regulation.

I am sure you are aware of the fact that the Auditing Standards Executive Committee of the A.I.C.P.A. has circulated an exposure draft of

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*/ In 1940, following the McKesson-Robbins investigation, the Commission urged the formation of audit committees, composed of non-officer directors, to participate in arranging corporate audits. In 1972, the Commission endorsed the establishment of audit committees composed of outside directors for all publicly-held companies to provide more effective communications between independent accountants and outside directors, and thereby to safeguard further the integrity of corporate financial statements on which public investors rely. In 1974, in amending its rules to require disclosure in proxy statements of the existence or absence of audit committees, the Commission reiterated its support.

a new auditing standard which, if adopted, would require auditors to bring any questionable payments that they may find to the attention of a level of management high enough for corrective steps to be taken. If questionable payments by top management are discovered, such an approach will, of course, be enhanced if an audit committee is in existence.

Additionally, there has been considerable recent comment about steps that can be taken to make the role of the board of directors more meaningful. Some major corporations have already taken steps to restructure their boards so that a majority consists of outside directors. Indeed, the Chairman of Connecticut General has recently written us about actions taken by that corporation to create a board consisting only of outside directors and the chief executive officer. While we have no firm notion about the optimum relationship between outside and inside directors, we do believe it is a subject of considerable importance.

Finally, many thoughtful commentators and many major law firms have come to the conclusion that the effectiveness of the board of of directors and independent counsel is enhanced when the critical aspects of the two functions are kept separate. This, of course, raises the question of whether members of law firms which have the responsibility of advising the corporation, including the board, should also serve as members of that board of directors.

The importance of maintaining the truly independent character of the boards of directors of our larger corporations has been illustrated by the Commission's recent enforcement actions in the area of questionable or illegal corporate payments. Significantly, in some of these cases no audit committee existed. In the others, with a single exception, audit committees were either only operated during a portion of the time when the questionable payments were alleged to have been made, or not wholly independent of management. Accordingly, the resolution of these actions typically has involved the establishment of a committee comprised of independent members of the board of directors in order to conduct a full investigation, utilizing independent legal counsel and outside auditors to conduct the necessary detailed inquiries. The thoroughness and vigor with which these committees have conducted their investigations demonstrates the importance of establishing entirely independent audit committees as permanent, rather than extraordinary, corporate organs and encouraging the Board to rely on independent counsel.

With these thoughts in mind, we have been considering various approaches to increase the likelihood that larger public corporations will establish audit committees composed of outside directors, that they will take further steps to make the role of the board of directors more meaningful, and that corporate boards will deal with independent counsel. One particularly promising approach to accomplish these goals would be for the Exchange to amend its policies and practices. As the Company Manual points out, the Exchange's listing agreement constitutes a code of performance to which companies commit when listing their securities on the Exchange. When the listing agreement was first instituted in 1899, the Exchange took the lead in the field of financial disclosure by requiring regular financial reports from listed companies; subsequently, independent public accountants were required.

The Exchange's listing policies have expanded in scope over the years. Specifically, the Exchange has long urged the desirability of including outside directors on corporate boards and specifically charging them with ensuring full disclosure of corporate affairs. In its 1973 White Paper on financial reporting, the Exchange recommended that audit committees, preferably comprised exclusively of outside directors, be formed. This recommendation represented a reaffirmation of a principle first raised by the Exchange in 1940.

In keeping with this tradition, the Exchange now could take the lead in this area by appropriately revising its listing policies, thus providing a practical means of effecting these important objectives without increasing direct government regulation. The objectives are sound in principle and, if implemented, they would significantly advance the public interest.

We would very much appreciate receiving your views on whether the New York Stock Exchange would find it appropriate to alter its listing policies along the lines discussed above. We are sensitive to the fact that, to the extent the Exchange's listing policies impose burdens which corporations might otherwise avoid, the attractiveness of listing on the Exchange may be diminished. But, at the same time, the Exchange has frequently recognized that it could provide effective leadership where its initiatives were consistent with developments in public policy in the fields of corporation finance, management, stockholder relations and accounting, and recent surveys suggest that perhaps two-thirds of NYSE listed companies already have independent audit committees.

We look forward to receiving the benefit of your views, particularly as to what Commission action, if any, in this area would be useful. We would be pleased to meet with you to discuss these matters further.

Sincerely,

Roderick M. Hills
Chairman