

2. Rule 13b2-2 prohibits the making of materially false or misleading statements to an accountant in connection with an audit or the filing of required reports.

B. The Commission stated that the rules were promulgated for the following purposes: to assure that an issuer's books and records accurately and fairly reflect its transactions and dispositions of assets; to protect the integrity of the independent audit of issuer financial statements that is required under the Securities Exchange Act and existing Commission rules; to promote the reliability and completeness of financial information that issuers are required to file with the Commission, or disseminate to investors, pursuant to the Securities Exchange Act; to promote compliance with the accounting provisions; and to prevent the concealment of questionable or illegal corporate payments and practices.

C. In promulgating Regulation 13B, the Commission pointed out that the accounting provisions are not exclusively concerned with the preparation of the financial statements.

D. With respect to scienter, the Commission noted that the accounting provisions contain no indication that the Congress intended to include such a limitation in the statute.

IV. THE COMMISSION'S STATEMENT OF POLICY CONCERNING THE ACCOUNTING PROVISIONS

A. On January 13, 1981, the Commission issued a statement of policy concerning the accounting provisions of the FCPA. See Securities Exchange Act Release No. 17500 (Jan. 29, 1981), 46 F.R. 11544 (Feb. 9, 1981), 21 SEC Docket 1466 (Feb. 10, 1981).

1. The policy statement expressed the view that uncertainty concerning the scope and meaning of the Act could have a debilitating effect on efforts to comply with the statute.

2. It also recognized that "business resources may have been diverted from more productive uses to overly-burdensome compliance systems which extend beyond the requirements of sound management or the policies embodied in the Act."

3. The Commission set forth certain views and policies that had been developed in the three years since the statute was enacted:

a. The Commission stated its view that the "reasonable detail" standard does not mandate absolute exactitude in recordkeeping, nor does the "reasonable assurances" standard require achievement of an ideal system of internal accounting controls; the concept of reasonableness tolerates certain deviations from the ideal and encompasses cost-benefit analysis.

b. The policy statement asserted that the accounting provisions "justify * * * deference to [management] decisions concerning corporate records and [internal accounting] control mechanisms" and that the issuer "need not always select the best or the most effective control measure * * *" as long as the one selected is reasonable under the circumstances.

c. The Commission stated that the principal purpose of the accounting provisions "is to reach knowing or reckless conduct; and

d. The Commission took the position that, where an issuer controls more than 50% of the voting securities of a subsidiary, the issuer would be held responsible for subsidiary compliance with the accounting provisions; similarly, if the issuer owned between 20% and 50% of the voting securities of the subsidiary, it would be responsible subject to a demonstration that its ownership does not amount to control, but where the issuer owned less than 20% of the voting securities of a subsidiary, the issuer would have no responsibility, unless the Commission could demonstrate control in fact.

V. PROPOSED AMENDMENTS TO ACCOUNTING PROVISIONS

A. S. 414, the proposed Business Accounting and Foreign Trade Simplification Act, would amend the accounting provisions.

1. S. 414 would eliminate the existing requirement that reporting companies "make and keep records which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer."

a. However, S. 414 would continue to hold management responsible for providing reasonable assurances that corporate transactions are recorded accurately and in reasonable detail.

b. As Statement on Auditing Standards No. 1 reflects, "The objective of accounting control with respect to the recording of transactions requires that they be recorded at the amounts and in the accounting periods in which they were executed and be classified in appropriate accounts."

2. The bill would add a new provision prohibiting the knowing circumvention of a system of internal accounting controls.

a. This would include the deliberate falsification of books and records or other conduct calculated to evade the internal accounting controls requirement.

3. S. 414 would also define "reasonable assurances" as those that would "satisfy prudent individuals in the conduct of their own affairs, having in mind a comparison between benefits to be obtained and costs to be incurred in obtaining such benefits."

a. The cost-benefit test is presently contained in the legislative history of the Act, but is not set forth in the statute.

b. The test is consistent with the auditing standard which recognizes that "the cost of internal control should not exceed the benefits expected to be derived."

4. The bill would eliminate criminal liability for failure to comply with the requirement that issuers devise and maintain an adequate system of internal accounting controls.

5. The bill would provide a defense in a civil injunctive action if the issuer "shall show that it acted in good faith in attempting to comply" with the internal accounting controls requirement.

6. The bill would also provide that no injunctive relief shall be imposed with respect to any person other than an issuer, in connection with an issuer's failure to comply with the internal accounting controls requirement, unless such person knowingly caused the issuer to fail to devise or maintain a system of internal accounting controls that complies with the internal accounting controls requirement.

7. With respect to subsidiaries, the bill provides that any issuer holding 50% or less of voting power of a domestic or foreign firm is required only to proceed in good faith to use its influence, to the extent reasonable under the issuer's circumstances, including the relative degree of its ownership, to cause the domestic or foreign firm to devise and maintain a system of internal accounting controls consistent with the internal accounting controls requirement.

B. The Commission has supported enactment of S. 414 on the ground that it would eliminate ambiguities while preserving the objectives that the Commission and the Congress sought to achieve when the law was enacted in 1977.

VI. THE COMMISSION'S ENFORCEMENT OF THE ACCOUNTING PROVISIONS

A. As of April 1, 1983, the Commission had brought 27 enforcement actions under the accounting provisions since the FCPA was enacted in 1977.

1. These include 24 injunctive actions and 3 administrative proceedings.

2. 18 of the 27 enforcement actions, or two-thirds, have been brought since August 1981.

B. Violations of the accounting provisions have all been uncovered in connection with inquiries into other possible violations of the securities laws.

1. Each of the injunctive actions has involved allegations that the corporate defendant violated one or more disclosure requirements of the federal securities laws.

a. These include the antifraud provisions contained in Sections 10(b) of the Exchange Act, the reporting requirements set forth in Section 13(a), and the proxy provisions contained in Section 14(a) of the Act, and applicable rules promulgated under those provisions.

2. Two of the three administrative proceedings were based solely upon the accounting provisions, but these cases were settled on that basis in light of the particular circumstances involved.

C. The cases brought to enforce the accounting provisions have involved improper accounting with respect to four broad categories of conduct: questionable or illegal payments; exaggeration of company sales and assets, or the failure to keep adequate records of business transactions; misappropriation or diversion of corporate assets in cases that have not involved questionable or illegal payments; and unauthorized management perquisites.

EXAGGERATION OF SALES & ASSETS

SEC v. Charles M. Stange and Herbert E. Burdett, (N.D. Ca., C.A. 83-0762, March 17, 1983). [The Complaint alleged that defendants caused the Company to materially overstate its net worth, in part, because loss reserves of insurance claims were substantially understated.]

SEC v. William E. Nashwinter, Jr., (E.D. Va. Civ. Action No. 83-0064-R, Feb. 2, 1983). [The Complaint alleged that the defendant caused the company to materially overstate its inventories, in part, by overstating the quantities of specific food items when compiling the inventory from count sheets.]

SEC v. Jerold H. Maxwell and Larry A. Rasmusson, (D. Minn., No. 4-83 Civil 62, January 29, 1983). [The Complaint alleged that the company's sales and financial condition were overstated in certain filings, and that defendants had falsified the company's books and records.]

SEC v. Robert C. Kenney, et al., (SDNY, 83 Civ. 0425, January 13, 1983). [Several officers and directors were alleged to have falsified the books and records of Saxon Industries, Inc. by creating non-existent inventory on the records of various divisions of the company.]

SEC v. McCormick & Co. et al., (DDC, Civ. Action No. 82-5992, Dec. 21, 1982). [The Complaint alleged that a director of McCormick had engaged in a scheme to inflate the company's earnings by deferring certain expenses and reporting certain revenues before they were final.]

In the Matter of Ronson Corp., (Administrative Proceeding File No. 3-6191, Nov. 7, 1982). [The investigation revealed that a subsidiary of the company was engaged in a practice of prerecognition of sales which resulted in the existence of "off the books" inventory.]

SEC v. William E. Tate, (S.D. Miss., Civ. Action No. H-82-0175(R), Sept. 24 1982). [The Complaint alleged that a plant manager of a company falsified the production records of the plant which resulted in an inventory overstatement in excess of \$1 million.]

SEC v. Saxon Industries, Inc., et al., (SDNY, Civ. Action No. 82-5992, Sept. 9, 1982). [The Complaint alleged that defendants had falsified Saxon's books and records by creation of non-existent inventory on the records of various divisions of Saxon.]

In the Matter of Fidelity Financial Corp. and Fidelity Savings & Loan, (Exchange Act Release No. 18927, July 30, 1982). [The investigation revealed that the defendant corporations and a subsidiary had made false statements in connection with the offer of securities; had exaggerated the value of certain retail repurchase agreements; and had failed to disclose the company's deteriorating condition.]

SEC v. Flight Transportation Corp., (D. Minn., Civ. Action No. 4-82-874, June 18, 1982). [The Complaint alleged that the Flight Transportation Co. and its subsidiaries had reported gross revenues for certain years which had no basis in fact, and that in order to cover up serious cash shortages officers and others had kited checks between various accounts of the defendant companies.]

SEC v. Jack Friedland et al., (E.D. Pa., Civ. Action No. 82-1748, April 21, 1982). [The Complaint alleged that certain officers/directors of Food Fair, Inc. had engaged in a scheme to mask the deteriorating financial condition of the company.]

SEC v. William R. Bundy, et al., (S.D. Ind., Civ. Action No. IP81-1s350c, Dec. 18, 1982). [The Complaint alleged that defendants had overstated the financial strengths of Kokomo National Life Insurance Co. by falsifying its net worth.]

SEC v. Data Access Systems, Inc. et al., (D. N.J. Civ. Action NO. 81-3362, Oct 28, 1981). [The Complaint alleged that an individual defendant had caused the company to overstate its pre-tax earnings for certain years by improperly recording certain transactions as "sales" when the company was still at risk as to those transactions.]

SEC v. Computer Communications, (D.D.C., Civ. Action No. 81-2590, Oct. 19, 1981). [The Complaint alleged that the company and certain individuals had engaged in a scheme of recording revenues for certain transactions, which were not definite, in an attempt to conceal the deteriorating condition of the company.]

SEC v. Tiffany Industries, et al., (E.D. Mo., Civ. Action No. 81-1106-C, Sept. 10, 1981). [The Complaint alleged that as part of a scheme to exaggerate the company's sales and assets defendants had created false records and had made improper adjustments with respect to inventory.]

SEC v. World Wide Coin Investments, Ltd., (N.D. Ga., Civ. Action No. C-81-1642A, August 31, 1981). [The Complaint alleged that there was no documentation of certain purchases and sales of assets of the company and that there was inadequate controls over access to inventory.]

SEC v. Torotel Inc., et al., (W.D. Mo. Civ. Action No. 81-0116-CV-W-4, Feb. 13, 1981). [The Complaint alleged that the company and its subsidiaries had routinely counted sales occurring after the end of an interim quarter as net sales for the quarter already ended, resulting in false interim financial statements.]

SEC v. Wyoming Coal Corp. et al., (D. Wyo., Civ. Action No. C-79-312, Oct. 15, 1979). [The Complaint alleged that the company, aided and abetted by an individual defendant had failed to keep books and records which reasonably reflected the transactions and disposition of assets of the company.]

SEC v. International Video Corp. et al., (DDC, Civil Action No. 78-2316, Dec. 11, 1978). [The Complaint alleged that the sales and net income figures for certain quarterly reports were overstated because of the inclusion of reported sales of merchandise made after the end of those quarters.]

SEC v. LTV Corp. et al., (N.D. Tex., Civ. Action No. 3-78-1269-C, Oct. 1978). [The Complaint alleged that the company's income and retained earnings were overstated in certain financials because of the misapplication of "last-in, first-out" accounting principles.]

In the Matter of Movie Star, Inc., (Administrative Proceeding File No. 3-5537, Sept. 6, 1978). [The Commission found that certain filings of the company were deficient because they omitted to state the amount of inventory reserves and how they were utilized.]

SEC v. Eugene Farrow et al., (DDC, Civ. Action No. 78-0208, Feb 7, 1978). [The Complaint alleged that defendants had misrepresented the financial condition of Co-Build Companies, Inc. by failing to report losses in three subsidiaries and by improperly recognizing revenues from certain real estate transactions.]

In the Matter of National Telephone Co., Inc., (ASR-238, Jan. 16, 1978). [The investigation revealed that defendants had engaged in a scheme which exaggerated National's earnings by overvaluing certain leases and underestimating certain credit problems.]

SEC v. Sharon Steel Corp. et al., (DDC, Civ. Action No. 77-1631, Sept. 20, 1977). [The Complaint alleged that the company had shifted expenses and inventory amounts from one year to another in order to inflate its pre-tax earnings for those years.]

SEC v. FISCO, Inc. et al., (DDC, Civ. Action No. 77-1426, Aug. 18, 1977). [The Complaint alleged that defendants had falsely reported earning increases for the company by keeping inadequate reserves for insurance claims and by understating loss reserves.]

SEC v. Stephen Kneapler, et al., (S.D. Fla., Civ. Action No. 77-969, March 24, 1977). [The Complaint alleged that defendants had engaged in a scheme to falsify the closing inventory figures of the company and that as a result its earnings were increased in certain filings.]

SEC v. Giant Stores Corp. et al., (DDC, Civ. Action No. 76-1641, Sept. 2, 1976). [The Complaint alleged that defendants had overstated Giant's earnings by including in certain financial statements false supplier credits, false future rebates and false advertising credits.]

SEC v. Omni-Rx Health Systems, et al., (DDC, Civ. Action No. 76-1623, Sept. 1, 1976). [The Complaint alleged that the company's income and assets were overstated through its failure to establish a provision for loss on its accounts receivable and by its improper capitalization of certain costs.]

SEC v. SaCom, et al., (DDC, Civ. Action No. 76-1624, Sept. 1, 1976). [The Complaint alleged that the company's net income and assets were overstated through the capitalization of various costs, which had been previously expensed, and through the improper recognition of a claim.]

SEC v. Cenco Inc., et al., (N.D. Ill., Civ. Action No. 76-C-3258, Sept. 1, 1976). [The Complaint alleged that inventory was fictitiously "created" with false documents and then "destroyed" to conceal the massive inflation of the inventory of a subsidiary.]

SEC v. General Financial Services, Inc., et al., (E.D. Va., Civ. Action No. 76-562-A, July 23, 1976). [The Complaint alleged that defendants had overstated the income of certain partnerships and had misrepresented the real property holdings of said partnerships.]

SEC v. Chicago Milwaukee Corp. et al., (DDC, Civ. Action No. 76-1204, June 29, 1976). [The Complaint alleged that defendants had engaged in a scheme to mask the deteriorating financial condition of the company and its subsidiaries including failing to disclose that one company was selling off timberland to stay solvent.]

SEC v. Emersons Ltd. et al., (DDC, May 1976). (The Complaint alleged that the company had overstated its net income, its meat inventories, and its accounts receivables.)

SEC v. Stirling Homex Corp. et al., (DDC, July 2, 1975). [The Complaint alleged that the companies financial statements were false because of the fraudulent recording of certain fictitious sales and because of the application of inappropriate accounting principles.]

SEC v. Solitron Services, Inc., (DDC, March 20, 1975). (The Complaint alleged that the company's annual reports were false and misleading because inventory, sales, and accounts receivables were overstated, and because a substantial contingent liability was not disclosed.)

SEC v. Mattel, Inc., (DDC, August 5, 1974). [The Complaint alleged that the company's filings had overstated profits and had understated costs by failing to make interim and year-end adjustments for inventory, accounts receivables, tooling, returns and insurance claim receivables.]

SEC v. Penn Central Co., et al., (E.D. Pa., 74 Civ. 1125, May 2, 1974). [The Complaint alleged that the company had substantially understated the magnitude of the decline in its economic fortunes.]

SEC v. Keller Industries, Inc., (SDNY, May 1973). [The Complaint alleged that the company's filings included substantially inflated earnings and that a registration statement contained fraudulent, unaudited earnings.]

SEC v. Equity Funding Corp., (C.D. Cal., No. 5849, April 16, 1973). [The Complaint alleged that the company's financial statements were false and misleading in that fictitious insurance policies were used to inflate earnings.]

SEC v. National Student Marketing Corp., (DDC, Civ. Action No. 225-72, Feb. 3, 1972). [The Complaint alleged that the company's financial statements were false and misleading because its sales and income were substantially overstated and because material facts concerning the company's business operations and its transactions with certain directors and employees were not disclosed.]

QUESTIONABLE OR ILLEGAL CORPORATE PAYMENTS

SEC v. Crown Cork & Seal Co., Inc., (DDC, Civ. Action No. 81-2065, Sept. 2, 1981). [The Complaint alleged that approximately \$5.1 million of Crown Cork funds were directed to the benefit of a senior officer of one of Crown Cork's major customers.]

SEC v. International Systems & Controls Corp. et al., (DDC, Civ. Action No. 79-1760, July 9, 1979). [The Complaint alleged that over \$23 million of corporate funds were paid to foreign officials and entities in order to assist the company in securing contracts.]

SEC v. Schenley Industries Inc. and Rapid American Corp., (SDNY, Civ. Action No. 0855(60), Feb. 26, 1979). [The Complaint alleged that the company had failed to disclose that it had expended approximately \$6 million by granting illegal discounts to selected purchasers.]

SEC v. Page Airways, Inc. et al., (DDC, Civ. Action No. 78-0656, April 12, 1978). [The Complaint alleged that corporate funds were paid to foreign officials and entities to assist the sale of certain aircraft.]

SEC v. Charles Jacquin et Cie Inc., et al., (DDC, Civ. Action No. 77-1794, Oct. 17, 1977). [The Complaint alleged that the defendants had made undisclosed payments to state alcoholic beverage control officials as inducement to purchase Jacquin products.]

SEC v. Inflight Services, Inc. and Joel Peter Flexer, (SDNY Civ. Action No. 77-5011, Oct. 14, 1977). [The Complaint alleged that the corporate funds had been used to pay undisclosed compensation to certain employees of company suppliers.]

SEC v. SCA Services Inc., et al., (DDC, Civ. Action No. 77-1374, August 8, 1977). [The Complaint alleged that facts relating to certain political contributions made from corporate funds were concealed in the materials filed with the Commission.]

SEC v. Firestone Tire & Rubber Co., et al., (DDC, Civ. Action No. 76-1064, June 15, 1976). [The Complaint alleged that illegal payments were made to various candidates for federal, state and local office, and to a Mexican trade association from corporate funds, without disclosure.]

SEC v. Chicago Milwaukee Corp. et al., (DDC, Civ. Action No. 76-1204, June 29, 1976). [The Complaint alleged that defendants had failed to disclose a political contribution.]

SEC v. Emersons Ltd., et al., (DDC, May 1976). [The Complaint alleged that defendants paid out and received unlawful payments and made false statements with respect to those payments.]

SEC v. Stirling Homex Corp. et al., (DDC, July 2, 1975). [The Complaint alleged that financial statements were misleading in that they failed to disclose pay-offs, political contributions and the personal use of corporate funds by certain defendants.]

MANAGEMENT'S BUSINESS TRANSACTIONS

RELATED PARTY TRANSACTIONS

SEC v. Catawba Corp. et al., (DDC, Civ. Action No. 81-2640, Nov. 2, 1981). [The Complaint alleged that certain filings were false and misleading because they failed to disclose that the defendant public companies had paid substantial fees to Catawba Corp., a company owned by the officers and directors of the public companies.]

In the Matter of Michigan National Corp., (Administrative Proc. File No. 3-6036, Release No. 17602, June 30, 1981). [The investigation revealed that the company failed to adequately disclose that its subsidiary banks engaged in the sale and lease back of certain bank premises with certain officers and directors of the subsidiary banks, at terms very favorable to those officers and directors.]

SEC v. James Robert Meek, et al. (W.D. Okla. Civ. 81-227T, Feb. 24, 1981). [The complaint alleged that Meek used company funds, accounts and credit for his benefit and the benefit of Major Improvement Corp. his wholly-owned corporation.]

SEC v. Cloyce K. Box and OKC Corp. (W.D. Tex., Civ. Action No. 3-80-1217, Sept. 15, 1980). [The complaint alleged that the chief operating officer caused the company to purchase and sell substantial amounts of petroleum products through certain brokers who were his friends and/or business associates at preferential prices.]

SEC v. Jack M. Catain, Jr. & Rusco Industries, (C.A. Cal., Civil Action No. 80-02947, July 8, 1980). [The Complaint alleged that the individual defendant engaged in a scheme in which Rusco funds were used for his personal benefit and/or the benefit of certain of his relatives and associates through their distributorships.]

SEC v. Falstaff Brewing Corp., 629 F.2d (1980). [The court found that a proxy statement had failed to disclose the Chairman of the Board's prior dealings with the company, especially his purchase of a Falstaff brewery and had failed to disclose that he had guaranteed certain of the company's loans.]

SEC v. Rapid-American Corp., (DDC, Civ. Action No. 79-2128, August 1979). [The complaint alleged that Rapid entered into agreements and paid fees to personal creditors of, or persons with business relationships with, Rapid's Chairman of the Board.]

SEC v. American Financial Corp., et al. (DDC, Civ. Action No. 79-1701, July 2, 1979). [The complaint alleged that defendants failed to disclose substantial loans without proper collateralization made to former directors and subsidiaries; bonus payments to a director; and certain further related party transactions.]

SEC v. The National Bank of Georgia, et al., (N.D. Ga., Civ. Action No. 78-752A, May 3, 1978) [The complaint alleged that defendants engaged in a series of related party transactions including substantial questionable loans to defendants, their relatives, business associates and entities which they controlled.]

SEC v. Basic Food Industries, Inc., et al., (DDC, Civ. Action No. 77-1787, Sept. 15, 1977). [The Complaint alleged that the former Chairman of the Board had failed to disclose that he had a business relationship with a company that had received a \$97,000 advance from Basic.]

SEC v. SCA Services, Inc., et al., (DDC, Civ. Action No. 77-1374, August 8, 1977). [The Complaint alleged that a former officer of SCA had used corporate funds, without disclosure, to pay debts of the Carlton Hotel Corp., which he privately owned.]

DIVERSION OF CORPORATE ASSETS

SEC v. Frederick P. DeVeau, et al., (W.D.Tex., Civ. Action No. SA-82-CA411, Dec. 17, 1982). [The Complaint alleged that the individual defendant had acquired control of two companies and had used their assets to fund his own private acquisitions, and had systematically looted one of those companies.]

In the Matter of Government Securities Management Co., (Administrative Proceeding File No. 3-6153, July 21, 1982). [The Commission found that the company's inadequate accounting controls made possible the embezzlement of \$1.55 million of corporate funds by a clerk, and prevented the discovery of the misappropriation.]

SEC v. El Dorado International, Inc., Deil O. Gustafson, Inc., et al., (DDC, Civ. Action No. 81-0532, March 5, 1981). [The Complaint alleged that the defendants engaged in a scheme which allowed the individual defendant to divert over a million dollars of corporate funds for his benefit.]

SEC v. John E. Marquall and Sheldon Lubitz, (SDNY, 80 Civ. 2289, April 28, 1980). [The Complaint alleged that the individual defendants diverted over \$3 million in assets from the Atlantic Improvement Corp. to a corporation owned by Marquall.]

SEC v. Steven G. Weil, et al., (M.D. Fla., Civ. Action No. 79-440-T-H, April 10, 1979). [The Complaint alleged that the company's filings were false and misleading because they failed to disclose that the individual defendants had misappropriated and diverted company assets.]

SEC v. Aminex Resources Corp. et al., (DDC, Civ. Action No. 78-0140, March 9, 1978). [The Complaint alleged that the company and two of its officers had engaged in a scheme of corporate looting which diverted corporate assets to defendants' benefit.]

SEC v. American Commonwealth Financial Corp., et al., (N.D. Tex., Civ. Action No. 3-77-0648, May 12, 1977). [The Complaint alleged that the individual defendants had acquired stock of one of the defendant corporations in order to divert its funds and to service a prior debt.]