Fireside Chat: Accounting Aspects of the Foreign Corrupt Practices Act
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THERESA GABALDON: I'm Theresa Gabaldon, Lyle T. Alverson Professor of Law at The George Washington University School of Law, and moderator of the Fireside Chats. As our listeners may know, the SEC Historical Society preserves and shares the history of the US Securities and Exchange Commission and of the securities industry through its virtual museum and archive at www.sechistorical.org. The museum's collections are free and accessible worldwide at all times. The virtual museum and archive, as well as the Society, are separate and independent of the SEC and receive no federal funding.

We thank ASECA, the Association of SEC Alumni Inc., and Pfizer Inc., for their generous sponsorship of the 2007 Fireside Chat season. Their support, along with gifts and grants from many other institutions and individuals, are helping to make possible the growth and outreach of the virtual museum this year.

Today's Fireside Chat looks at the accounting aspects of the Foreign Corrupt Practices Act. The Foreign Corrupt Practices Act was enacted in 1977, now three decades ago. The global economy has changed tremendously in these past 30 years. What does the Act mean in today's international business community, how have the SEC's expectations of the act's applications changed over the past 30 years and how are companies meeting these expectations?

I am delighted to be joined this afternoon by Philip Ameen, Vice-President and Comptroller of General Electric Company; and Teresa Iannaconi, Partner in Charge of the SEC and Practice Advisory Group, KPMG LLP. Their remarks today are solely their own, and are not representative of this Society. Our speakers cannot give legal or investment advice.

Before we begin our discussion. I want to share with you a little history from a speech archived in the Papers section of the virtual museum. In January 1981, then SEC Chairman Harold M. Williams gave a speech entitled "The Accounting Provisions of the Foreign Corrupt Practices Act and Analysis" to the American Institute of Certified Public Accountants. During his presentation Chairman Williams made this statement: "The anxieties created by the Foreign Corrupt Practices Act – among men and women of utmost good faith – have been, in my experience, without equal. This consternation can be attributed, in significant part, to the spectre which some commentators have raised of exposure to Commission enforcement action, and perhaps criminal liability, as a result of technical and insignificant errors in corporate records or weaknesses in corporate internal accounting controls."

Phil and Terry, welcome.

PHILIP AMEEN: Good afternoon Theresa.

TERESA IANNACONI: Good afternoon.

THERESA GABALDON: We probably should start with a very brief overview. What is the Foreign Corrupt Practices Act, and who should care?

TERESA IANNACONI: Theresa, the Foreign Corrupt Practices Act is legislation that was passed by Congress, as you said, in 1977, that amended the Securities Exchange Act of 1934. The legislation was passed following several years of Congressional hearings that resulted from public awareness of the fact that many U.S. companies had been engaged in paying corrupt bribes to foreign officials for purposes of advancing their businesses. When the public became aware of this, there was obviously a lot of very negative press that led to the Congressional hearings and the Congressional hearings, in turn, led to the legislation.

There are two major provisions of the Foreign Corrupt Practices Act, one of which is an obvious and natural outcome of what had transpired in terms of Congressional hearings, and that's what is called the anti-bribery provision of the Foreign Corrupt Practices Act. The anti-bribery provision makes it unlawful for a United States person or certain foreign issuers of securities to make corrupt payments to foreign officials for the purpose of obtaining or retaining business or directing business to any person. In 1998, the Foreign Corrupt Practices Act was also amended to apply to some foreign firms and persons who take actions that are in furtherance of corrupt payments.

But the second provision, which is the provision we are going to talk about today, is what's called the record keeping provision. The record keeping provision requires companies whose securities are listed in the United States to meet certain accounting provisions. Specifically these accounting provisions were designed to operate in tandem with the anti-bribery provisions of the Foreign Corrupt Practices Act, and require corporations covered by the provisions to make and keep books and records that accurately and fairly reflect transactions of the corporation and to devise and maintain an adequate system of internal accounting controls.

In response to your question of who should care, any company, including management and board of directors of companies subject to the provisions of the Foreign Corrupt Practices Act, as well as the auditors and advisors, should care about the Foreign Corrupt Practices Act, because the Foreign Corrupt Practices Act imposes very significant penalties for violations.

THERESA GABALDON: You mentioned that there was public awareness of certain wrongdoing in foreign corrupt practices. What types of activities were the companies engaging in and how widespread were the practices that we are talking about?

TERESA IANNACONI: In tandem with the Congressional hearings, the SEC conducted investigations that identified that more than 400 U.S. companies acknowledged making questionable or illegal payments that were in excess of $300 million to foreign governments and officials and politicians and political parties. These abuses ran the gamut from bribery of high foreign officials to secure some type of favorable action by a foreign government to so-called facilitating payments that were made or allegedly made to ensure that government functionaries discharged certain ministerial or clerical duties such as processing customs papers or export papers. Congress enacted the Foreign Corrupt Practices Act to bring a halt to the bribery of foreign officials and, more importantly, to restore public confidence in the integrity of the American business system. The FCPA was intended to and has had an enormous impact on the way American firms do business. A number of firms that paid bribes to foreign officials have been the subject of criminal and civil enforcement actions, some have resulted in very large fines or suspension or debarment from federal procurement contracting and some

of the employees and officers have gone to jail. To avoid consequences, many firms have implemented detailed compliance programs intended to prevent and detect any improper payments by employees and agents.

THERESA GABALDON: I am definitely interested in hearing more about the types of programs that have been implemented and finding out whether they have changed over time, but am intent first of all, in finding out just a little bit about who was present at the birth of the FCPA.

TERESA IANNACONI: I think probably the best source of information on who was there is actually the SEC Historical Society museum and archive since there is a wealth of information on the Foreign Corrupt Practices Act. I would encourage anybody who has an interest in FCPA to mine that museum because it's got such a great amount of data on it. I think one of the more colorful characters who was present at the birth was Stanley Sporkin, the very famous former Director of the Division of Enforcement of the SEC, and now in practice of law, having gone through the CIA and the federal judgeship on the way. Clearly he was one of the moving forces and in fact if you look at some of the history, Stan was very outspoken at the time about his horror at the degree of bribery that was taking place, and was certainly a leading force in the investigations as well as the support of the Act itself.

Interestingly, the person who was the Chief Accountant of the SEC at the time the Foreign Corrupt Practices Act was passed was none other than Clarence Sampson, probably one of my all time favorite accountants at that stage of my career. Clarence was, when I first came with the SEC in 1969, at the Commission then and was in many respects a mentor to all of us and a man of great integrity. As the Chief Accountant of the SEC at the time, I'm sure he was a great supporter of the FCPA. So those are certainly two of the people that were there at the birth.

THERESA GABALDON: Terry, you mentioned earlier both accounting provisions and internal control provisions. Phil, could you explain the basic differences there?

PHILIP AMEEN: The accounting provisions relate to the necessity of keeping proper books and records. The internal control provisions run to the systems themselves that are necessary to ensure that those books and records are kept. We have migrated somewhat down the evolutionary path of defining internal control systems with Sarbanes- Oxley, and we have given thought in the intervening 25 year period to what constitutes effective control systems. I think we are just more thoughtful now and more thorough in our assessment of how to look at, how to test and how to evaluate control systems than we were then. But it’s been an evolutionary process and I think we are all much better informed now than we were 25 years ago.

THERESA GABALDON: Would you say then that the basic notion of what an effective control system is, has changed itself over time?

PHILIP AMEEN: I am not sure that the basic notion has changed. The notion would still be that we have systems in place to capture or record and ensure the propriety of the transactions. But I think the discipline with which we think about those systems has certainly come a long way. Also, the absolute requirement to keep those systems, the criminal penalties associated with failure to have them in Sarbanes-Oxley and auditor certification, is a big step -- a controversial one but a major one.

THERESA GABALDON: I am curious to find out whether the FCPA really did add some requirement that wasn't already being imposed by reasonable auditing standards. Was it something new and shocking, that people should be keeping adequate records and maintaining effective internal controls?

TERESA IANNACONI: I would say that the answer is no. There really wasn't an intention to add something new. And in fact, if you look at the history of the Act, you know one of the things that you find in the statements by officials, that the intent was to leverage off of what was then auditing standard one, that required there to be systems of internal controls that were adequate to ensure the preparation of financial statements and records were kept. So I think the answer is, no, there really probably was not intended to be nor was there something incremental to what was already required by auditing standards.

THERESA GABALDON: That said, certainly, based on that quote from Chairman Williams' speech that I read earlier, there was something resembling a great hue and cry in the wake of the FCPA. What would account for that?

TERESA IANNACONI: Certainly you are right about that, and in going back and reading the various testimonies and speeches around that time, there was an incremental amount of work that was necessary by public companies to do in order for them to feel that they were compliant with the FCPA. One presumes that there may have been more rigor around the documentation and the care with which systems of internal control were structured.

PHILIP AMEEN: I was in public accounting at the time, so I am not an authority on the historical implications for companies like mine. But what you see now in terms of entire compliance departments, organizations and disciplines are relatively recent phenomena and the result of the Foreign Corrupt Practices Act.

TERESA IANNACONI: I can think back to even when I was an undergraduate, we talked about the internal controls as part of a company's framework for reporting. Certainly the auditing standards did indicate the ability of auditors to place reliance on internal controls in terms of designing and structuring an audit. So clearly there was the notion. I think what I would say is that there was not the rigor around the concept of internal controls that perhaps was felt to be necessary in order to ensure compliance with a specific act that imposed criminal sanctions for the failure to have those systems. It is one thing to say, I have a system of internal controls that is sufficient to prepare my financial statements, and satisfy my auditors. And of course auditors can always adjust audit procedures where internal controls are weak. But I think when you impose criminal sanctions as a result of a failure, you probably do create a mindset that is different than when it is simply something that you do as part of a presumed good business practice.

PHILIP AMEEN: In sort of an abstract sense, once a transaction is captured then yes we can re-examine it and re-characterize it and make sure that it is reported properly. One thing that a controls system is absolutely necessary for however is to make sure that the transactions are actually captured. It's not possible to know that your books and records contain all of the transactions that you are attempting to represent without a control system.

TERESA IANNACONI: One of the interesting aspects of Williams' speech is his discussion of materiality versus reasonableness where he focuses on materiality as a financial statement concept that helps us to identify when we need to disclose something. But reasonableness has more to do with sort of a common sense approach to what you're doing. He notes in his speech that if we were to design internal controls only to identify material transactions, we might be designing internal controls that only look at transactions that are of significance. For example, if we talk about a large company we might only be designing a system of internal controls to track transactions that could be in the millions of dollars, whereas if you design an internal controls system that's intended to provide reasonable assurance about the preparation of financial statements, you're going to be looking at transactions that are individually smaller than what you might call material but which in the aggregate are necessary in order to ensure the integrity of financial statements. I think you get a sense in his speech that besides materiality and reasonableness in the internal controls is a very important concept in terms of the adequacy of the system of internal controls.

PHILIP AMEEN: The volume and velocity of transactions in the modern economy means that if you take a business like a credit card business with countless transactions you replicate many times. A small mistake would be repeated many times can certainly mount up to a large number.

THERESA GABALDON: As you described it almost sounds as though Chairman Williams' speech might be taken to say, don't think that you design your systems just to address materiality. We really are asking for something that's more demanding than that. Yet at the same time I remember rather vividly that that speech was regarded as somewhat soothing to the persons who Williams was describing as being men and women of utmost good faith -- who were very, very concerned. Would you agree that he was actually signaling that more was required rather than less?

TERESA IANNACONI: I think at least one part of what he was trying to respond to was an expressed concern that because there was no materiality standard in the new legislation, that meant that inadvertent violations of very small amounts could result in criminal penalties, and that people that were responsible for the preparation of financial statements had to figure whether or not an inadvertent, immaterial omission or error could result in some kind of sanctions. I think what he was saying, and it is very clear in his speech, he says first of all, these people of good faith, these people of utmost good faith who are not engaging in knowing or reckless misconduct because those are words he uses repeatedly in his speech, if you are not involved in knowledgeable, reckless misconduct with inadvertent violations where there is a system of internal controls that's reasonably assures the protection of financial statements, that's not what they are after. They are after these people who are bribing and who are knowingly and recklessly ignoring known violations and there are omissions and errors in financial statements.

PHILIP AMEEN: I think the word reason itself is comforting to you, regardless of the scale of what we are talking about. Certainly, the speech in its entirety was a reassuring phenomenon.

THERESA GABALDON: Why do you suppose that he chose to act that way rather than calling for some sort of more formal rule making which perhaps would have set out standards more specifically?

TERESA IANNACONI: One of the things I have thought about in that regard is first of all, the medium through which he delivered this speech, the AICPA's Annual Current Developments Conference, and that conference has for decades and decades been the sort of premier financial reporting conference that accountants and preparers attend to find out what is the latest and greatest on the SEC's mind. Even today, it is probably the single largest accounting conference I am aware of and it is certainly considered to be the pre-eminent medium by which the SEC does deliver informal views on a variety of topics. So I think certainly the medium he chose was one where there was high visibility.

Interestingly though, within a couple of weeks after he delivered speech at the AICPA conference, the speech in its entirety was incorporated into a document that was published as the Commission's policy on the Foreign Corrupt Practices Act. On the one hand the speech was an immediate highly visible, highly promulgated mechanism for getting something out quickly, and at the same time, it became more formal through the mechanism of the '34 Act release that followed.

PHILIP AMEEN: It is a bit of an unusual speech for that forum in that Commissioners are not normally on the agenda. Normally it'll be the SEC staff. So it was the right audience for making that kind of announcement and certainly he got their attention.

THERESA GABALDON: Do you think the SEC is perceived as keeping the promises implicit in the Williams speech?

TERESA IANNACONI: I think that that's an interesting question. I think that certainly it's the intention of the Commission that the actions that the staff seeks or the Commission seeks with respect to Foreign Corrupt Practices Act, are focused on knowing and reckless conduct. I guess that views could differ on whether or not that's accomplished, but I would certainly say that when you read the various enforcement actions that are taken, I think the focus is on the same messages that you find in the Williams speech.

THERESA GABALDON: Do you happen to know how active SEC and Justice Department Enforcement programs were in the immediate wake of his speech?

TERESA IANNACONI: There is, I think in November 1983 or so, a piece of testimony by John Fedders in connection with a proposed amendment of the Foreign Corrupt Practices Act. I think that testimony, which is again in the SEC Historical Society museum and archive, makes mention of something like 21 or 23 cases that had been brought at that point. If the Act was passed in -- I think it was passed in December of '77, pretty late in the year in '77 -- so from '77 to '83, if they had 21 cases, that would suggest that they were only maybe 3 or 4 a year. I don't know how to evaluate that other than to say, by today's standards, that seems like not a lot of activity but it may have seemed like a lot of activity at the time.

THERESA GABALDON: Now what kinds of penalties really are trends of the FCPA? What kinds of sanctions are called for by the securities laws themselves?

TERESA IANNACONI: There are different penalties depending upon which part of the Act you are talking about. With the respect to the bribery provisions there are criminal penalties for violations of the anti-bribery provisions and they can be quite severe. The corporations and businesses are subject to a fine of up to $2 million per violation on the anti-bribery provisions and individuals can be subject to a fine of up to $250,000 per

violation and imprisonment for up to 5 years and under certain circumstances the actual fine can be twice the benefit that the individual, the offending party, sought to obtain by making the corrupt payment. In addition, the Attorney General or the SEC can bring a civil action for a fine of up to $10,000 for violation against any issuer or against any individual.

With respect to the books and records violations, any person who violates the books and records provisions can be subject to a fine of up to $5 million and can be imprisoned for not more than 20 years or both and except that if the violation made by an issuer rather than an individual, the fine can be not in excess of $25 million. So we are talking some big money, it is one of those a million here, a million there, that adds up.

THERESA GABALDON: I can see how that would be a tension to you.

TERESA IANNACONI: I think just a sense of how big that can get, earlier this year, Vetco was the subject of a penalty and they paid about a $26 million fine. Baker-Hughes, who was also subject to FCPA action earlier in the year, paid a $44 million fine. So there are some significant fines being imposed.

THERESA GABALDON: Do you have any idea how the SEC and/or the Justice Department goes about deciding what level of penalties to seek?

TERESA IANNACONI: I couldn't tell you what their thought processes are but I can tell you that both the SEC and the Department of Justice have guidance with respect to mitigating considerations. So, for example the SEC issued, in connection with an enforcement action several years ago, the Seaboard report. That report was what's called a 21A report which is an advisory report. In the Seaboard report, the SEC indicated that when businesses self report and rectify a legal conduct or otherwise cooperate with the Commission staff and large expenditures of government and shareholder resources can be avoided and investors can benefit more promptly, that would be a positive consideration in terms of their seeking any remedies. In addition, the Seaboard report indicates that consideration will be given first of all to the nature of the misconduct, management's involvement and the duration of the misconduct. So obviously, the more serious the misconduct and the higher the level in the company it goes and the length of time that it persisted are considerations. The Seaboard report also indicates that the SEC will consider the degree of harm to investors; they would also consider whether or not the company had corporate controls in place and whether or not there was self-disclosure and co-operation and additionally, would consider whether or not the company subsequently adopted measures to prevent violations in the future.

With respect to the Department of Justice, we can look to the Federal sentencing guidelines. There have been a couple of documents that indicate considerations, originally the Thompson memo that was superseded in December by the McNulty memo, which indicates the Department of Justice would consider similar factors in considering prosecuting business organizations. They would look at the nature and seriousness of the offence, the pervasiveness of the wrongdoing, the history, if any, of the company having similar misconduct, and whether or not there was voluntary self disclosure. I would say, most important, it's a very important consideration whether or not the company had in existence a compliance program, and whether or not there were adequate remedial measures after the discovery of the wrongdoing, whether there were

collateral consequences. And interestingly, I will add as a sidebar here, up until relatively recently, cooperation included the waiver of attorney-client privilege. There were indications in the last few months that waiver of attorney-client privileges is not considered a factor in determining whether or not leniency should be granted in connection with the DoJ action.

PHILIP AMEEN: Spontaneous answer.

TERESA IANNACONI: Spontaneous answer.

THERESA GABALDON: I am interested then in following up on what a compliance program consists of or looks at. Phil, could you tell us something about that?

PHILIP AMEEN: Compliance programs start necessarily with the tone at the top in the business: the top of the organization, the top of the business unit, the top of the sales unit that's involved. That tone is necessarily responsive to the kinds of risks that the organization is exposed to. In our business, selling light bulbs in the domestic U.S. to department stores is not much of a risk of inappropriate action. But when we are selling large capital equipment in developing countries against competition, not necessarily bound by the same requirements, we have in place a very, very high level of attention from top management down, we have attorneys who will accompany our sales people. It's difficult to absolutely ensure that nothing ever happens but it's certainly necessary that you set the right tone of business engagement that you simply don't tolerate this kind of activity.

THERESA GABALDON: Has there been much change over time in the types of compliance programs we're talking about?

PHILIP AMEEN: My career doesn't span the entire Act of course and I wouldn't be able to say specifically that we have seen recent changes. The programs that I am aware of have been stable in a sense and we believe them to be effective. I believe we are satisfied with the level of assurance we are getting.

TERESA IANNACONI: I will say that when I was back in the SEC, I think that there is a continuing evolution of awareness of the importance of compliance programs. I think it's one of the Shad speeches that talks about there being back in the early part of the '80s an awareness of things like governance, as part of the compliance program. For example, the existence of independent audit committees is a relatively recent phenomenon, the idea of having audit committees with independent directors and the idea of having independent internal audit that reports to an audit committee rather than reporting to management. Other aspects of governance that create an atmosphere in which there is an accountability to sort of an external party with respect to aspects of compliance by the company, I think these are developments that have occurred.

I think it was while I was at the SEC that the Treadway Commission report came out. I think at that point the New York Stock Exchange already required independent audit committees, but the other exchanges hadn't required it. We are talking maybe 1988 or so. The American Stock Exchange and other exchanges didn't require independent audit committees. I remember the Commission making an effort to try to encourage other exchanges to adopt requirements for independent audit committees, and it was not successful in some respects. There was a lot of sort of moral suasion that could be

brought and yet, there was no means of compelling. And yet today of course we take the idea of an independent audit committee very much for granted. You wouldn't dream of having a public company that didn't have an independent audit committee, but I think of the whole concept of compliance programs as being something very evolutionary.

If I go back and stand in 1977 we were in a very different environment than we are today. And over 30 years, we have seen more and more emphasis on compliance and the need to have programs, not only to identify wrongdoing. First of all, before you can even prevent wrongdoing, you do have to have some kind of a mapping within your organization to identify what your important compliance requirements are. Then you have to have a mechanism for collecting data about that compliance against that map. And then after you collect it, you have to have some kind of a means of analyzing it to determine how serious it is, and then a means of remediation. And I think that those are steps that, in 1977, my speculation would be the average company didn't even think that way. And yet today, I think that's very much the way companies do think. But I think it is an evolution of not only the Foreign Corrupt Practices Act, but the various enforcement activities that have taken place in between. I think Sarbanes-Oxley has made it even a sharper focus than it was, as a result of FCPA.

PHILIP AMEEN: One way of seeing in a sort of compressed timeframe the operation of the Foreign Corrupt Practices Act is to look at acquisitions that U.S. companies do with non-US companies. Whether or not you can conduct due diligence activities in a tender offer, for example, you may have sufficient diligence. But it is routine and customary quickly to insert a finance organization from the acquiring company and a compliance organization from the acquiring company to absolutely ensure that there are no compromises, that the disciplines are instilled, that people that we the acquirer know well and trust to an extreme are in place with responsibilities for making sure that the compliance programs are at the sufficient level in the acquired company.

THERESA GABALDON: I am sure there is no real answer to this but these things that you are talking about sound rather costly. Can you give any kind of ballpark at all, as far as say how much General Electric might be spending in this day and age because of the Foreign Corrupt Practices Act that it wouldn't otherwise be spending?

PHILIP AMEEN: Less than what we would be spending if we didn't have the systems in place, I am sure.

THERESA GABALDON: Nicely put.

TERESA IANNACONI: That's an excellent point, because I certainly have seen public statements by regulators and others that if you save $10 million on a compliance system, but you have a violation and you get fined $50 million then you didn't save $10 million, you lost $40 million. I think that the cost of systems is dwarfed by the cost of violations.

PHILIP AMEEN: Violations have a deeper poison within the system. It is not just a matter that you are getting business improperly. You remove the competitive drive to get the best product in the market for the best price when you imbalance the market in that fashion.

THERESA GABALDON: We've talked about penalties and hopefully minimization of penalties, and so forth. But I am also interested in finding out if there is something that tends to attract the attention of the enforcers in the first place. Do you think that there are things or locations or anything of that sort that either the SEC or the Justice Department keeps a watchful eye out for?

TERESA IANNACONI: We know for a fact that the SEC does. The SEC has made it very public that they have an office in their Division of Corporation Finance that monitors disclosures with respect to certain countries, specifically the countries that sponsor terrorists and terrorism organizations. As you read SEC comment letters, you can't fail to be conscious of the fact that they are raising comments with respect to filings where companies are disclosing significant business relationships in countries that have, let's just say, a spotty track record in terms of integrity. I will just pick on a country, Nigeria. There was a recent article about you virtually can't do business in Nigeria without paying a bribe. So presumably, if the article is on point and I have no reason to think that it isn't, I would think the disclosure of the fact that you are doing significant business in Nigeria, I'll just say, if I was a reviewer at the SEC and I read the article and the next thing I did was pick up a filing from a company that does significant business in Nigeria, I would be probably writing them a comment to say tell me more about it. I think that there are certain countries and certain industries that present opportunities -- or opportunities is probably the wrong word -- vulnerabilities in terms of FCPA.

PHILIP AMEEN: Absolutely. We are very conscious of business practices in the countries in which we are doing business and balance our compliance activities accordingly to be responsive to the risks in a particular environment.

TERESA IANNACONI: One thing that presents an interesting risk is any time that you get into a business that does business in a country where you have nationalized services, you run into some sort of unique risks. If you have a country that's got a nationalized healthcare program, doctors may be government officials. So if you send your doctor a basket of fruit in appreciation for his great care of your patients and promoting your products, you probably are borderline FCPA. I think that there are risks in countries where you have a lot of nationalized services. Nigeria, as I recall, is one where they've got a lot of nationalization in the oil and gas operation, which is one reason perhaps you might have higher risk in Nigeria, because you have got this nationalized business operation, which means that something that wouldn't be an FCPA violation in a country with non-nationalized business could be an FCPA violation, because of nationalization of that particular aspect of that particular industry in that country.

THERESA GABALDON: I'm curious to find out if there's a third leg to the enforcement stool. The Justice Department can bring criminal prosecutions, and the SEC can bring civil enforcement and injunctive actions. Is there any role for private plaintiffs?

TERESA IANNACONI: The Foreign Corrupt Practices Act does not provide for private right of action. I'm not a lawyer, so I'm not giving private legal advice here, but it's my understanding that there's no private right of action specifically. But as we all know, because the securities laws are primarily disclosure laws, the absence of disclosure of about virtually anything can give rise to a legal action under securities laws. So, presumably, if you were paying bribes to foreign officials, and it was a violation of the Foreign Corrupt Practices Act, then that in itself exposed the company to significant

regulatory action. The failure to disclose that you were doing something that creates a significant uncertainty, presumably could be used as a lever by the private securities bar to bring actions. So, I think the answer is, no there's no private right of action. But it isn't hard to find a right of action when you have a disclosure statute.

THERESA GABALDON: Makes sense. Do professionals like for instance, accountants have to be concerned with the FCPA for reasons other than advising their clients. That is, do they have something to fear directly?

TERESA IANNACONI: Auditors in particular, I think, have a heightened obligation to be vigilant and diligent about awareness of FCPA and other illegal acts because Section 10A of the '34 Act imposes on the auditor an obligation that when the auditor becomes aware of a possible illegal act by a client or its personnel, that the auditor is required to go through a series of procedures to ensure that the company takes timely and appropriate remedial action with respect to the illegal act. That consists of an up-the-line reporting. It's brought to the attention of management. If management doesn't take the appropriate remedial action then it goes to the audit committee. If the audit committee doesn't take the appropriate remedial action, I think they then go to the full board. But ultimately if at the highest level, the company doesn't take timely and appropriate remedial action, and I have to stress timely, then it's the obligation of the auditor to report the matter to the SEC. I will tell you that we internally educate our people on their responsibility under Section 10A, and send out reminders. We have some very agonizing calls at times over whether or not matters that are identified are remediated. I want to emphasize timely, because it isn't enough that it is appropriate if the diligence and the speed with which the remedial action taken is inadequate, then that creates a need for us to think about whether or not we have a reporting obligation to the SEC.

PHILIP AMEEN: And the 10A obligation does not have a materiality standard.

TERESA IANNACONI: The standard under Section 10A is applicable unless it is clearly inconsequential, and the clearly inconsequential is further defined as taking into account not only the action itself, but any possible fines or other costs that will be associated. So when you're determining whether or not something is clearly inconsequential, it isn't enough to say somebody, it was only a $10,000 payment to a foreign official. You have to consider what the costs of fines and penalties and other costs of the discovery would mean in terms of the ultimate outcome. If you figure you got a $2 million per action per violation fine as a possibility, or in the case of books and records, it was at about $5 million. A $10,000 bribe is not nearly as important as the fines and penalties and assessing whether or not something is clearly inconsequential.

PHILIP AMEEN: The Act does not bring to the auditor responsibility to look for such violations, however serious it could be.

TERESA IANNACONI: There's no specific obligation to look for Foreign Corrupt Practices Act violations. But if they come to your attention, we do have a reporting obligation.

THERESA GABALDON: Is the state of the art of Section 10A compliance something that's evolved over time? Has it been known since 1977 that there was some responsibility to report up the ladder?

TERESA IANNACONI: I don't remember specifically when Section 10A was adopted. I think maybe the last decade or so. I don't think it existed in 1977. But I will say that since it's been adopted, the auditing firms have been well aware of what its requirements are.

THERESA GABALDON: Has there been much tinkering with the FCPA over time?

TERESA IANNACONI: I'd say relatively little. There certainly have been a number of attempts to get it amended, particularly if you look back on that early 1980s era, the '81.'82,'83, '84 period, there were a number of attempts to get it amended. There's some interesting testimony there. I remember reading one set of testimony by somebody from the Commerce Department questioning whether or not FCPA should even be within the jurisdiction of the SEC because it was outside of what one normally thinks of as the purview of the SEC. In some testimony by John Fedders, he questions whether or not the Commission needed the books and records provisions of the FCPA on the basis that he believes that the SEC had plenty of tools in the securities laws otherwise to prosecute the violations that would be the subject of FCPA, at least the record keeping tools. But, other than several runs at that, I don't think anything significant was done to change it, although it has been brought in to encompass foreign companies doing business in the U.S. But that was much later.

PHILIP AMEEN: I hear from time to time attempts to argue whether in fact the anti-bribery provisions are necessary or good for business. What's happened, I think, globally is very interesting. Rather than our dropping the anti-bribery provisions they seem to be coming into legal force around the world. So, the rest of the world in some sense is following in an FCPA-type legislation.

THERESA GABALDON: Would you say that the FCPA requirements have been in any way amplified or supplemented by Sarbanes-Oxley?

TERESA IANNACONI: Let's talk about the internal control provisions because that of course is the thing that comes to mind. FCPA requires that you have a system of internal controls that is reasonably designed to result in financial statements in accordance with GAAP. So, it's a pretty broad requirement. If you look back at what the auditing standards on which that was based, you certainly have a requirement for some form of adequate internal control. But in 1977, there was no framework that defined what an adequate system or effective system of internal control was. And it's only after the Treadway Commission report in the next decade, and then the subsequent establishment of the Committee of Sponsoring Organizations, COSO, and then their later development of a framework of internal control, which iI think went into the early '90s by the time -- it's '90, '91 when we get the framework that we really have some, I guess I'll say some robustness around a definition -- not definition, it goes beyond a definition -- but more bells and whistles in terms of specifics as to what are the components of an adequate system of internal controls.

So by the time Sarbanes-Oxley comes along, and mandates that companies have an assessment of the effectiveness of internal control based on a recognized framework, it's really a much different environment, because you do have a framework. In fact, not only do you have a framework, but by then you've got almost a decade of history of having banks having to report on the effectiveness of internal control using the COSO framework. So it's really quite a different environment.

PHILIP AMEEN: The control role has certainly changed from the '70s, we are much more automated now. Just the extent of IT creates its own risks, but certainly creates its own control opportunities. The big strides and the most controversial part of Sarbanes-Oxley was the mandatory documentation testing and auditor certification of your systems of internal control. So within the framework that Terry referred to, we now know what further steps we must take in order to get and, in turn, give our investors assurance about the operations of those control systems.

THERESA GABALDON: I read somewhere about an organization that actually provides information about places that companies need to be particularly careful.

PHILIP AMEEN: You're referring to Transparency International…

THERESA GABALDON: That sounds familiar.

PHILIP AMEEN: …which is an organization that General Electric was among the founding members of, in the early '90s. Transparency International is probably most widely known for its Corruption Index, which tells you just how dangerous it is to do business in various locations. I refer you to their web site, www.transparency.org. It's really a terrific exploration of corruption and how it affects various businesses in various parts of the world and a very interesting site.

THERESA GABALDON: Do they provide explanations for how we go about figuring out which countries are more corrupt than others?

PHILIP AMEEN: There is a disciplined routine for evaluating that. I am assured that it is not by attempting to make bribes.

THERESA GABALDON: We talked about the people who were present at the birth of the FCPA. Do you have any thoughts on any subsequent standouts that personalities and characters of the FCPA over the last three decades?

TERESA IANNACONI: I don't really, although we talked about Stan Sporkin and Clarence Sampson there at the birth, and I have mentioned a number of other people, particularly John Shad, subsequent Chairman of the SEC, who did in fact provide testimony to Congress in connection with the several attempts to amend the Act. I guess Shad is a standout from the perspective of his perhaps not seeing the FCPA as being as necessary as perhaps his predecessors. John Fedders is also a person who testified, and particularly noting that the SEC had other tools. I am not sure I have anyone else who kind of jumps into my mind as being a standout on FCPA.

THERESA GABALDON: I would say that's my general impression too that there are some aspects, the federal securities laws, there's a name you associate with a particular doctor, whatever but this is a sort of an ensemble piece.

PHILIP AMEEN: It's also very much become the way we do business. So it's not something in which you would expect there to be a standout, leadership kind of role at this point.

THERESA GABALDON: Is there any way that either one of you could easily describe in which you think the FCPA accounting provisions could be improved. If you were king and queen of the world and could rewrite that statute, would you?

TERESA IANNACONI: Phil, would you?

PHILIP AMEEN: I think what it provides us is a framework that we can get the attention of and force activity down throughout our organization. It is not just a good idea, it's not just the way we do business, it is the law. This is all a coherent framework in which we are conducting our business. I am not sure that I would actually change it in a meaningful sense.

TERESA IANNACONI: Yes, I am not sure I would either. And I'll tell you one of my reflections on, as I was thinking about Foreign Corrupt Practices Act and particularly when I was reading Chairman Williams' speech was, in a sense it is the great experiment in our principles-based standard setting. We are doing an awful lot of discussion today about -- wouldn't the world be better if we had principles-based accounting standards. I looked at this and I thought this is a principles-based standard because it is a piece of legislation that doesn't have bright lines, it doesn't have exceptions, it doesn't have any of the things for which rules are criticized. It is a standard of reasonability. And then, if you take that together with Chairman Williams' speech where he talked about people acting in good faith, and it specifically identifies it's the reckless wrongdoing, it's the reckless and knowing wrongdoing, that's wrong. I think it's a tremendous tribute to the legislators that passed it that it was a principles-based standard that really has in many respects stood the test of time. I think that as long as the statute is administered, as it was intended to be administered, it will continue to be a good standard. So perhaps I'll look at it and say, here's an example of principles based, let's see, why did it work and why does it continue to work as a model, perhaps for some of the work that's being done today to try to look at less complexity and more principles based.

PHILIP AMEEN: But interesting to think back over the adoption period, how we have gotten to this state. There was the angst at inception and a bit of settling out period and now it doesn't create so much furor.

TERESA IANNACONI: I think perhaps because of Williams' reassurance that reasonableness was the crux of the standard, and as long as reasonableness is the crux of the standard and not some overbearing mechanical test of accuracy, then people can take comfort in the fact that reasonableness is what it's intended to be, it's what average people do.

PHILIP AMEEN: But it should not be a comfortable standard. It is not meant to be. And the compliance doesn't arrive from a comfortable environment. It requires good faith and requires an awful lot of that continued effort.

TERESA IANNACONI: When I think about reasonableness, I think one of the things that we look at today when we consider reasonableness is whether or not companies have in fact implemented reasonable means to ensure that corrupt payments are not going to be made, things like education programs in vulnerable environments, and the appropriate kinds of monitoring and remediation of infractions. I consider that the reasonableness is

all couched in the idea that reasonableness encompasses the entire program of compliance, and the way in which it's administered within a company.

THERESA GABALDON: Would you say that, what I've read about, as being the recent explosion of enforcement activity is simply a reminder of what the obligations are? Or have the opportunities for wrongdoing multiplied in this day and age?

TERESA IANNACONI: I guess one of the things that I reflect on is that we all know that globalization is proceeding apace and globalization means going into environments where you haven't been before. And some of the environments in which there is tremendous economic growth, unfortunately are also environments that historically have not had well developed histories of sound business practices. So to the extent that for example, and I don't mean to pick on any particular group of countries but if it's a Eastern Bloc country, that may be a vulnerable environment.

THERESA GABALDON: Terry and Phil, thank you for this very informative discussion on the Foreign Corrupt Practices Act and its accounting provisions.

I would also like to thank ASECA, the Association of SEC Alumni Inc. and Pfizer Inc. for helping to make possible today's Fireside Chat. The chat is now archived in audio format in the virtual museum, so you can listen again to the discussion at any time. A transcript of the discussion as well as the audio in MP3 format will be accessioned in the online program section in the coming months.

Our 2007 Fireside Chats will conclude next month with a discussion of Section 404 of the Sarbanes-Oxley Act. Please join Kurt Schacht of the CFA Institute, Herbert Wander of Katten Muchin Rosenman LLP, and me on Tuesday, October 16th at 3:00 PM, Eastern Time. Thank you again for being with us today.