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SECURITIES ENFORCEMENT

The SEC's Unlawful and Dangerous Expansion of the Exchange Act

The SEC has applied the "internal controls" and "books and records" provisions to hiring interns and reinstituting an airline route. A careful review of statutory language and legislative history, however, demonstrates that the Commission has ventured far beyond the authority that Congress granted in these accounting provisions.

By Michael N. Levy and Amanda L. Fretto

In a series of recent settled enforcement actions with major U.S. companies involving the hiring of interns and the reinstatement of an airline route, the Securities and Exchange Commission (SEC) progressively has expanded what it believes to be the scope of Sections 13(b)(2)(A) and (B), commonly known as the "books and records" and "internal controls" provisions, of the Securities Exchange Act of 1934 (Exchange Act).[1] As discussed below, the plain meaning and congressional intent of these provisions addressing "internal *accounting* controls" and "books, records, and *accounts*" that fairly reflect "*transactions*" and the disposition of "*assets*" clearly establish that these recent resolutions reflect an expansion by the SEC of the Exchange Act well beyond any reasonable reading.[2] If allowed to persist, this expansion not only is unlawful, but it also hands the SEC the capacious authority to regulate by enforcement almost any aspect of the operations of any issuer. Congress did not grant that authority to the SEC when it passed these provisions,[3] and the SEC should not be allowed to seize that authority today.

Background

In 1976, as concerns grew about the payment of bribes to foreign government officials to obtain business in those countries, members of Congress began to question the "double-bookkeeping" and "off-the-books accounts" that had facilitated those payments.[4] Likewise, the SEC itself published a report on May 12, 1976, that focused on how improper accounting in companies' books and records facilitated the making of improper payments and may have created material misstatements or omissions in companies' financial statements.[5] Throughout the development of what became the "internal accounting controls" and "books, records, and accounts"

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provisions added to the Exchange Act by the Foreign Corrupt Practices Act (FCPA), members of Congress, the SEC, and witnesses at hearings consistently spoke of the need to address corrupt *payments*. The focus was on the use of funds to pay bribes and how those bribes would be recorded (or disguised) in companies' *financial* records. There were no broad discussions, or even references, to the use of other potential benefits—such as providing internships or offering particular services—in an effort to gain influence. Although the FCPA's anti-bribery provision contains broad language covering the giving of "anything of value" to a foreign official,[6] neither the "internal accounting controls" provision nor the "books, records, and accounts" provision speaks with such flexible language. Both the plain meaning and legislative history of those two provisions make clear that they are dedicated exclusively to accounting concepts and do not apply broadly to all "internal controls" or all "records" used by companies in the course of running their businesses.

The "books, records, and accounts" provision, Section 13(b)(2)(A) of the Exchange Act, states that issuers shall:

> make and keep books, records, and *accounts*, which, in reasonable detail, accurately and fairly reflect the *transactions* and *dispositions of the assets* of the issuer.[7]

The text of the statute, therefore, limits the "books, records, and accounts" at issue to those books, records, and accounts that reflect the "*transactions*" and "dispositions of the *assets*" of the issuer. The provision requires accuracy only in the types of records one ordinarily would find in the financial records of a company—documents that record financial transactions, the generation of revenue, and payment of expenses—that ultimately roll up to the financial statements filed with the SEC and disclosed to investors. The provision uses the terms "accounts," "transactions," and "assets" for a reason; it is an *accounting* provision. It is not a provision that requires accuracy in all records anywhere in a company, whether or not they are related to the accounting concepts of "transactions" or the disposition of "assets."

Likewise, the text of the "internal accounting controls" provision is limited to *accounting* controls. In this regard, Section 13(b)(2)(B) of the Exchange Act states that issuers shall:

> devise and maintain a system of internal *accounting* controls sufficient to provide reasonable assurances that:
>
> (i) *transactions* are executed in accordance with management's general or specific authorization;
> (ii) *transactions* are recorded as necessary (I) to permit preparation of *financial statements* in conformity with *generally accepted accounting principles* or any other criteria applicable to such statements, and (II) to maintain accountability for *assets*;
> (iii) access to *assets* is permitted only in accordance with management's general or specific authorization; and
> (iv) the recorded accountability for *assets* is compared with the existing *assets* at reasonable intervals and appropriate action is taken with respect to any differences.[8]

The text of the statute makes clear that the provision governs only "internal *accounting* controls." The conclusion that, like the "books, records, and accounts" provision, this too is an accounting provision is further buttressed by the succeeding subsections that refer repeatedly to accounting concepts like recording "transactions" as necessary to prepare "financial statements" in conformity with "generally accepted accounting principles." Subsection (iv), for example, mandates that companies perform basic inventory accounting and reconciliation at reasonable intervals. Thus, Section 13(b)(2)(B) of the Exchange Act is limited on its face to "internal accounting controls," not, as often described, all "internal controls." The distinction is critical and reflects the unambiguous

meaning of the term "internal accounting controls" as understood by members of Congress, the President, and the SEC itself at the time this legislation was passed.

The origins of the "internal accounting controls" and "books, records, and accounts" provisions are quite clear. As part of its 1976 Report on Questionable and Illegal Corporate Payments and Practices, the SEC proposed amendments to the Exchange Act that were "nearly identical to the [internal accounting controls and books, records, and accounts] provisions ultimately contained in the Act."[9] Explaining the source of its proposal, the SEC stated:

> Because the accounting profession has defined the objectives of a system of accounting control, the Commission has taken the definition of the objectives of such a system contained in our proposed legislation from the authoritative accounting literature. American Institute of Certified Public Accountants [("AICPA")], Statement on Auditing Standards No. 1 [(SAS 1)], 320.28 (1973).[10]

Subsequent statements by the SEC, in legislative reports, and at congressional hearings uniformly referred to SAS 1, and its Section 320.28 in particular, as the definitive source of the "internal accounting controls" provision.[11] The role of SAS 1, Section 320.28 as the "authoritative accounting literature" from which the language of the "internal accounting controls" provision of the Exchange Act was derived essentially verbatim is fundamental to understanding that statutory provision.

SAS 1, Section 320 expressly distinguished "accounting controls," as defined in Section 320.28, from "administrative controls," as defined in Section 320.27. "Accounting controls" are the organizational plan, procedures, and records for "the safeguarding of *assets* and the reliability of *financial records*" that are designed to achieve the same four elements as the "internal accounting controls" provision of the Exchange Act.[12] In contrast, "administrative controls" are the organizational plan, procedures, and records "that are concerned with the decision processes leading to management's authorization of transactions."[13] As the standard framed it, such "authorization is a management function directly associated with the responsibility for achieving the objectives of the organization."[14] To avoid any ambiguity, SAS 1, Section 320.49 expressly stated that "accounting control is within the scope of the study and evaluation of internal control contemplated by generally accepted auditing standards, while *administrative control is not*."[15] Thus, it is clear that Congress intended the "internal accounting controls" provision of the Exchange Act to cover accounting controls and *not* administrative controls.

SAS 1 repeatedly distinguished between accounting controls, which relate directly to an auditor's examination of a company's financial statements, and administrative controls, which relate only indirectly to a company's financial statements. Accounting controls must be audited as part of an examination of financial statements.[16] In contrast, "constructive suggestions to clients for improvement" in administrative or managerial controls are "incident to an audit engagement" and expressly "not covered by generally accepted auditing standards."[17] Administrative controls "are concerned mainly with operational efficiency and adherence to managerial policies and usually relate only indirectly to the financial records."[18] Indeed, in SAS 1, the AICPA expressly rejected a definition of accounting controls that broadly would have covered any "means of protection against something undesirable."[19] Such a broad definition of accounting controls would have applied,

> for example, [to] a management decision to sell a product at a price that proves to be unprofitable … to a decision to incur expenditures for equipment that proves to be unnecessary or inefficient, for materials that prove to be unsatisfactory in production, for merchandise that proves to be unsaleable,

> for research that proves to be unproductive, for advertising that proves to be ineffective, and to similar management decisions.[20]

One easily might add to that list hiring interns who are unqualified and offering products, services, or airline routes that are unprofitable.[21] SAS 1, Section 320—the express basis for the "internal *accounting* controls" provision of the Exchange Act—directly rejected such a broad definition.[22]

Likewise, the legislative history of the "books, records, and accounts" provision demonstrates that Congress, the President, and the SEC all intended that provision to apply to the books, records, and accounts "that are relevant to the preparation of financial statements," not to any and all records located anywhere in a company.[23] Nothing in the legislative history suggests otherwise. Both the "internal accounting controls" and "books, records, and accounts" provisions were consistently referred to at the time as "accounting" provisions.[24] Indeed, the provisions appeared in Section 102 of the Foreign Corrupt Practices Act of 1977, which was entitled "Accounting Standards."[25] Moreover, the legislative history reflects that, like the "internal accounting controls" provision, the "books, records, and accounts" provision was drafted from an accounting and auditing perspective and applies to the *financial* records of the company from which the company's external financial statements are derived.[26] Contemporaneous statements demonstrate the clear understanding by both Congress and the SEC that the provision requires an issuer's books, records, and accounts to "reflect *transactions* in conformity with accepted methods of recording *economic* events."[27]

In proposing the "books, records, and accounts" provision, the SEC called it "a prohibition against the falsification of corporate *accounting* records."[28] The goal was to ensure that corporate "funds" used to make questionable "payments" would be accurately recorded so that the financial statements "filed with the Commission and circulated to shareholders do not omit or misrepresent material facts."[29] Indeed, the Senate Committee on Banking, Housing and Urban Affairs stated that the requirement of Section 13(b)(2)(A) already was "implicit in the existing securities laws" but ought to be made explicit.[30]

The "books, records, and accounts" provision merely requires that companies do what they already were required to do.

In other words, the "books, records, and accounts" provision merely requires that companies do what they already were required to do: maintain financial records such that their publicly reported financial statements are not materially misstated. In discussing the proposed legislation, the SEC had the same perspective and objective for the "books, records, and accounts" standard: "Absent reliable underlying corporate records, the preparation of financial statements in accordance with generally accepted accounting principles would be extremely difficult."[31] Indeed, in one of the rare comments about the accounting provisions made during congressional debate, Senator John Tower, a member of the Senate Banking Committee, explicitly stated that the "books, records, and accounts" provision did not

> establish a new accounting standard. Its purpose is to require that books and records are kept so that financial statements prepared in accordance with generally accepted accounting principles can be derived from them.[32]

This legislative intent—to have the "books, records, and accounts" provision mandate the maintenance of those records needed to compile materially accurate financial statements—also is logically consistent with and complementary to the "internal accounting controls" provision of the Exchange Act passed in conjunction with it.[33] Financial records that are used for "external reporting," for example, are within the scope of internal accounting controls as

described by SAS 1 and as set forth in Section 13(b)(2)(B) of the Exchange Act, but records that are used for "internal management" are not. SAS 1, Section 320.17 expressly discussed "the two separate purposes for which the financial records may be used[,] internal management and external reporting," while Section 320.19 stated that the definition of accounting control set forth in Section 320.28 clarified that accounting control extends only "to the reliability of financial records for *external reporting* purposes (see paragraph .17)."[34] Likewise, financial "books, records, and accounts" that are "kept so that financial statements prepared in accordance with generally accepted accounting principles can be derived from them" fall within the scope of Section 13(b)(2)(A) of the Exchange Act, but the vast majority of corporate documents do not.[35]

Analysis of Recent SEC Enforcement Actions

In a series of recent settled enforcement actions, however, the SEC has expanded its interpretation of these accounting provisions well beyond any reasonable reading of their plain meaning or congressional intent. As a result, the SEC has asserted for itself, without any judicial oversight, a vast authority to regulate through enforcement almost every aspect of every business listed as an issuer in the United States. This asserted power reflects a dangerous regulatory incursion by the SEC into aspects of American commerce in which it has neither expertise nor lawful authority.

This incursion began in August 2015 when the SEC and The Bank of New York Mellon agreed to the entry of a cease-and-desist order pursuant to Section 21C of the Exchange Act.[36] The SEC alleged that BNY Mellon provided internships to the sons and a nephew of two foreign officials in an effort to obtain or retain business from the sovereign wealth fund for which the officials worked. In addition to alleging a violation of the anti-bribery provision of the FCPA,[37] the SEC alleged a violation of the "internal accounting controls" provision of the Exchange Act for failing to "devise and maintain a system of internal accounting controls around its hiring practices."[38] The dearth of controls to which the SEC pointed in support of this allegation, however, had nothing to do with accounting. The SEC alleged that certain employees had "wide discretion" to make initial hiring decisions, human resources was not trained to "flag" potentially problematic hires, and the bank had "no mechanism to ensure that potential hiring violations were reviewed by anyone with a legal or compliance background."[39] "Legal or compliance" controls, however, are not "accounting controls," and "hiring violations" involve violations of precisely the type of "administrative controls" that do not fall within the meaning of "internal accounting controls" for purposes of the Exchange Act and SAS 1. The SEC did not charge BNY Mellon with violations of the "books, records, and accounts" provision of the Exchange Act, perhaps because none of the "hiring violations" impacted the books, records, or accounts that rolled up into the financial statements to ensure they would not be materially misstated. For the same reason, of course, these types of allegedly flawed hiring controls are not internal *accounting* controls.[40]

A year later, in November 2016, the Commission extended its misuse of the Exchange Act to encompass the "books, records, and accounts" provision. The SEC charged another bank with violating the anti-bribery, "internal accounting controls," and "books, records, and accounts" provisions of the Exchange Act in connection with the bank offering employment and internships through a "Client Referral Program" in its Asia-Pacific region to obtain or retain business.[41] The SEC contended that the bank had "failed to devise and maintain a system of internal accounting controls around its hiring practices sufficient to provide reasonable assurances that its employees were not bribing foreign officials" by offering employment or internships to their family members or others.[42] Simply calling something an accounting control, however, does not make it an accounting control for purposes of the statute. As described above with respect to BNY Mellon, the human resources, legal, and compliance processes

described in the SEC's charges are administrative controls, not accounting controls. They impact financial records only indirectly and, on their face, involve human resources, legal, and compliance personnel and policies – not accountants and auditing.

The dearth of controls to which the SEC pointed had nothing to do with accounting.

Likewise, the "books and records" (the Commission simply omits references to the "accounts" portion of the provision) at issue were questionnaires developed to ensure compliance with internal company hiring policies.[43] Although those questionnaires may have had valuable legal and compliance objectives, they were not financial records and had nothing to do with the preparation of financial statements in accordance with generally accepted accounting principles. They were not books, records, or accounts that reflected "the transactions and dispositions of assets" within the plain meaning or legislative intent of Section 13(b)(2)(A) of the Exchange Act. If administrative controls failed and compliance questionnaires were inaccurate and that resulted in a violation of law over which the SEC has enforcement jurisdiction, then the SEC is well within its statutory authority to punish that resulting substantive violation. When the controls at issue, however, are not accounting controls and the documents are not "books, records, and accounts" involving transactions and the disposition of assets within the meaning of the Exchange Act, the SEC has no lawful basis to charge a company with violations of Sections 13(b)(2)(A) or (B) for failing to prevent that substantive violation.[44]

The most egregious disregard for the plain meaning and legislative intent of the "internal accounting controls" and "books, records, and accounts" provisions, however, came one month later, in December 2016, when the SEC reached a cease-and-desist agreement with United Continental Holdings.[45] The SEC alleged that United reinstituted a previously cancelled route from Newark, New Jersey, to Columbia, South Carolina, even though it was expected to be unprofitable, at the request of the Chairman of the Board of Governors of the Port Authority of New York and New Jersey, before which United had pending matters.[46] The Commission's reasoning attempting to justify "internal accounting controls" and "books, records, and accounts" violations was tortured.

In its Order, the Commission defined the internal decision by United's management to reinstitute the South Carolina route as "the Transaction."[47] Definitional legerdemain, however, does not magically convert into a "transaction" a decision about whether to offer for sale to the public a particular product or service, such as a particular airline route. Indeed, such a decision is precisely the type of management decision that is governed by administrative, not accounting, controls. As SAS 1 makes clear, "a management decision to sell a product at a price that proves to be unprofitable" or a "decision to incur expenditures … for merchandise that proves to be unsaleable" is governed by administrative controls and, accordingly, does not fall within the scope of SAS 1 or the "internal accounting controls" provision of the Exchange Act.[48] Likewise, the Commission's allegations that United violated its own compliance and ethics policies are inapposite.[49] Compliance and ethics policies may be very important, but they are not "internal *accounting* controls."

Compliance and ethics approvals are not "books, records, and accounts."

Remarkably, the SEC also alleged that United's failure to obtain the written approvals required by the company's compliance and ethics policies constituted a violation of the "books, records, and accounts" provision of the Exchange Act.[50] But the absence of a "transaction" dooms any such claim, and compliance

and ethics approvals are not "books, records, and accounts" that have anything to do with auditing or a company's preparation of financial statements. As with its *ipse dixit* definition of "the Transaction," the SEC also attempted to justify the "books, records, and accounts" charge by asserting that United did not make and keep records that accurately and fairly reflected the "*use* of assets" in connection with the South Carolina route.[51] Section 13(b)(2)(A), however, does not address records relating to the "use" of assets. It addresses records relating to "transactions" and the "dispositions" of assets.[52] "Disposition" of an asset in this context means "the act of transferring or relinquishing of that property to another's care or possession."[53] Transactions and the dispositions of assets are about the types of sales or transfers that would impact the financial statements. They are not about how an asset is "used," which relates to management's administrative operation of the business. Put simply, compliance and ethics records or records of administrative decisions by management do not equate to books, records, and accounts that accurately and fairly reflect the transactions and dispositions of assets of the issuer and, as such, are outside the scope of the plain meaning and legislative intent of Section 13(b)(2)(A).

The danger of this Order is further laid bare when one considers that the United matter had nothing to do with—and the "internal accounting controls" and "books, records, and accounts" provisions of the Exchange Act apply without regard to—foreign bribery. The United matter was wholly domestic and, accordingly, no "anti-bribery" charges were, or could have been, brought by the SEC. Considered in this light, the United Order is an assertion by the Commission that violations of internal corporate ethics and compliance policies, internal management decisions about what products and services to offer, and written authorizations (or the lack thereof) to proceed with such decisions fall within the SEC's power to enforce the Exchange Act, even in the absence of foreign bribery, breakdowns in genuine *accounting* controls, or any errors or irregularities in the financial books, records, and accounts from which a company's financial statements are derived. This is frightening.

Conclusion

Through this line of cases, culminating (for now) in the United Order, the SEC has ignored the clear limitations on its authority set forth in the carefully chosen words and unambiguous legislative intent of the "internal accounting controls" and "books, records, and accounts" provisions. Without the limitations that Congress put in the statute, the SEC stands to become, in practice, an über regulator of virtually all aspects of all businesses listed on U.S. exchanges. Based on the United Order, the SEC could charge violations of Sections 13(b)(2)(A) and (B) any time an issuer violated its own internal ethics, compliance, or other policies (the internal controls) or failed to get the proper written authorizations (the books and records) for just about any management decision with which the SEC disagrees after the fact. As described previously, the AICPA expressly rejected a definition of accounting controls in SAS 1 that would have covered any "means of protection against something undesirable," and, in adopting the language of SAS 1 in Section 13(b)(2)(B), Congress rejected it as well.[54] Not only would such an expansion of the SEC's powers be unlawful, but it also would alter fundamentally the allocation of power within the Executive Branch. It would enable the SEC to become, in effect, a primary regulator for all publicly-traded companies. The SEC, however, does not have the industry expertise to serve such a role. Indeed, one would think that the appropriate body to regulate decisions by airlines about whether to offer certain routes would be the Department of Transportation, not the SEC.

Moreover, such a dramatic distortion of the SEC's enforcement power is not necessary to ensure compliance with the law. In addition to the ability of primary regulators (such as the Federal Reserve, the Department of Transportation, and many other bodies that have expertise and authority over the industries they regulate) to make and enforce rules

governing the types of administrative management at issue in these three Orders, the Department of Justice retains the authority to enforce violations of our criminal laws. Indeed, the Department of Justice investigated and obtained a Non-Prosecution Agreement from United and a guilty plea from the former Chairman of the Port Authority for domestic bribery based on the company's establishment and operation of the South Carolina route.[55] There is no need, and no lawful authority, for the SEC to use Sections 13(b)(2)(A) and (B) to regulate this conduct.

In passing the Foreign Corrupt Practices Act, Congress did not authorize SEC enforcement actions for the failure of issuers to prevent wrongdoing writ large.[56] The "internal accounting controls" and "books, records, and accounts" provisions are carefully limited to matters relating to financial transactions, the sale or transfer of assets, and controls and records necessary to ensure that companies' financial statements are prepared in conformity with generally accepted accounting principles. They are not provisions that require issuers both to have and to comply fully with all of the legal, ethical, and compliance policies that govern the myriad of management judgments and administrative activities that occur every day in the life of a modern corporation. The SEC's assertion of such authority under the Exchange Act not only poses a threat to the appropriate allocation of authority within the regulatory state, but it also threatens to destroy any reasonable limits on the appropriate role of government in the business decisions of publicly traded companies.

Notes

1. In the Matter of The Bank of New York Mellon Corp., Exchange Act Release No. 34-75720, SEC File No. 3-16762, Order Instituting Cease-and-Desist Proceedings (Aug. 18, 2015) (BNY Order) (claiming violations of the anti-bribery and the "internal accounting controls" provisions for providing internships to relatives of foreign officials); In the Matter of JP Morgan Chase & Co., Exchange Act Release No. 34-79335, SEC File No. 3-17684, Order Instituting Cease-and-Desist Proceedings (Nov. 17, 2016) (JPM Order) (claiming violations of the anti-bribery, "books, records, and accounts," and "internal accounting controls" provisions for providing jobs and internships to relatives and friends of foreign officials); In the Matter of United Continental Holdings, Inc., Exchange Act Release No. 34-79454, SEC File No. 3-17705, Order Instituting Cease-and-Desist Proceedings (Dec. 2, 2016) (United Order) (claiming violations of the "books, records, and accounts" and "internal accounting controls" provisions in connection with reinstituting a flight route from Newark, New Jersey, to Columbia, South Carolina, for allegedly corrupt purposes).
2. 15 U.S.C. §§ 78m(b)(2)(A), (B) (emphasis added).
3. Congress passed these provisions in 1977 as part of the Foreign Corrupt Practices Act. Title I of Pub. L. No. 95-213, 91 Stat. 1494 (1977) (amending Section 13(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78m(b)). Subsequent amendments to the FCPA in 1988 and 1998 did not change the language of either Section 13(b)(2)(A), the "books, records, and accounts" provision, or Section 13(b)(2)(B), the "internal accounting controls" provision, of the Exchange Act. International Anti-Bribery and Fair Competition Act of 1998, Pub. L. No. 105-366, §§ 0001-0006, 112 Stat. 3302 (1998) (codified as amended in scattered sections of 15 U.S.C.) (making no changes to the FCPA's "accounting provisions"); Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, §§ 5001-5003, 102 Stat. 1107, 1415-25 (1988)) (codified as amended in scattered sections of 15 U.S.C.) (defining, in a new Section 13(b)(7), "reasonable detail" and "reasonable assurances" as used in Sections 13(b)(2)(A) or (B), but not altering the language of either of those provisions).
4. 122 Cong. Rec. S6515 (daily ed. May 5, 1976) (statement of Sen. Church); *see also* ABA Comm. on Corp. Law and Accounting, *A Guide to the New Section 13(b)(2) Accounting Requirements of the Securities Exchange Act of 1934 (Section 102 of the Foreign Corrupt Practices Act of 1977)*, 34 Bus. Law. 307, 328 (1978) ("1978 ABA Guide").
5. *See* SEC Rep. on Questionable and Illegal Corporate Payments and Practices, A-B (Comm. Print 1976), *reprinted in* Sec. Reg. & L. Rep. No. 353 (May 19, 1976) (submitted to the Senate Committee on Banking, Housing and Urban Affairs, 94th Cong.) (1976 SEC Report).

6. 15 U.S.C. § 78dd1(a). This article does not address whether providing internships to friends or relatives of foreign officials or deciding to offer particular goods or services for sale to the public constitutes the giving of "anything of value" to a foreign official for purposes of the Act's anti-bribery provision. Rather, this article focuses on the "internal accounting controls" and "books, records, and accounts" provisions of the Act because, as discussed *infra*, those two provisions are not tied statutorily solely to situations involving allegations of bribery of foreign officials and, accordingly, if misinterpreted or abused, could have a far broader, and more destructive, impact on the day-to-day business operations of issuers.
7. 15 U.S.C. § 78m(b)(2)(A) (emphasis added).
8. 15 U.S.C. § 78m(b)(2)(B) (emphasis added).
9. 1978 ABA Guide at 331. The only difference between the SEC's proposed amendment and the "books, records, and accounts" provision as passed was Congress's addition of the limiting phrase "in reasonable detail." *Compare* 1976 SEC Report at 63, *with* 15 U.S.C. § 78m(b)(2)(A); *see also* H.R. Rep. No. 95831, at 10 (1977) (Conf. Rep.) (Conference Report). The only differences between the SEC's proposed amendment and the "internal accounting controls" provision as passed was Congress's deletion of the superfluous word "adequate" modifying "system" and insertion of the phrase "general or specific" in subsection (iii). *Compare* 1976 SEC Report at 63-64, *with* 15 U.S.C. § 78m(b)(2)(B); *see also* Conference Report at 10.
10. 1976 SEC Report at 59; *see also id.* at 65.
11. *See, e.g.*, Questionable or Illegal Corporate Payments and Practices, Exchange Act Release No. 3413185, 42 Fed. Reg. 4854, 4856 (Jan. 26, 1977) (reiterating that the legislation proposed by the SEC would require issuers to devise and maintain a system of internal accounting controls that meets "the objectives articulated by the American Institute of Certified Public Accountants in Statement on Auditing Standards No. 1, section 320.28 (1973)"); S. Comm. on Banking, Housing, and Urban Affairs, Foreign Corrupt Practices and Domestic and Foreign Investment Improved Disclosure Acts of 1977, S. Rep. No. 95114, at 8 (1977) (confirming that "the definition of the objectives contained in this subparagraph is taken from authoritative accounting literature" and citing SAS 1, Section 320.28); *Foreign Corrupt Practices and Domestic and Foreign Investment Disclosure: Hearings on S. 305 Before the S. Comm. on Banking, Housing, and Urban Affairs*, 95th Cong. 220 (1977) (statement of N. Wolfson, Professor of Law, U. Conn.) (testifying that "[t]he statutory language, however, is not the careless invention of Senatorial staffers but is taken word for word from the authoritative accounting literature" and citing SAS 1, Section 320.28); S. Comm. on Banking, Housing, and Urban Affairs, Corrupt Overseas Payments by U.S. Business Enterprises, S. Rep. No. 941031, at 11 (1976) (1976 Senate Report) (noting that "the definition of the objectives contained in this subparagraph is taken from the authoritative accounting literature").
12. SAS 1, § 320.28 (emphasis added).
13. SAS 1, § 320.27.
14. *Id*.
15. SAS 1, § 320.49 (emphasis added).
16. *See, e.g.*, SAS 1, § 320.02 (distinguishing between management advisory and consulting services to study, evaluate, and improve administrative controls and "those audit services required for compliance with the auditing standard for study and evaluation of internal control *incident to an examination of financial statements*") (emphasis added); SAS 1, § 320.06 (noting that "[t]he purpose of the auditor's study and evaluation of internal control" for purposes of this auditing standard "is to establish a basis for reliance thereon … in his examination of the financial statements").
17. SAS 1, § 320.08.
18. SAS 1, § 320.10.
19. *See* SAS 1, §§ 320.14, 320.19.
20. SAS 1, § 320.14.
21. *See, e.g.*, BNY Order (hiring interns); JPM Order (hiring interns); United Order (offering an airline route from Newark, New Jersey, to Columbia, South Carolina).
22. In 1988, SAS 1 was superseded in pertinent part by SAS 55, which was amended in 1995 by SAS 78 and again in 2001 by SAS 94. *See* Consideration of the Internal Control Structure in a Financial Statement Audit, Statement on Auditing Standards No. 55 (Am. Inst. of Certified Pub. Accountants 1988) (SAS 55); Consideration of Internal Control in a Financial Statement Audit: An Amendment

to SAS No. 55, Statement on Auditing Standards No. 78 (Am. Inst. of Certified Pub. Accountants 1995) (SAS 78); The Effect of Information Technology on the Auditor's Consideration of Internal Control in a Financial Statement Audit, Statement on Auditing Standards No. 94 (Am. Inst. of Certified Pub. Accountants 2001) (SAS 94). For public companies, the Public Company Accounting Oversight Board (PCAOB) in 2003 adopted this amended version of SAS 55 and then in 2010 superseded that standard and dispersed its elements into a number of new standards. *See* PCAOB Release No. 2003006, Establishment of Interim Professional Auditing Standards, at 2-6 (Apr. 18, 2003); PCAOB Release No. 2010004, Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Related Amendments to PCAOB Standards, at A912, A913, A914, A918, A931, A935, A108, A1036, A1037, A1041 (Aug. 5, 2010). These succeeding accounting standards confirm that what SAS 1 referred to as administrative controls fall outside the scope of an audit of accounting controls. Indeed, the standards consistently emphasize an audit's focus on financial statement accuracy and reiterate the distinction between administrative and accounting controls drawn by SAS 1. *See, e.g.*, SAS 55.7 ("An entity generally has internal control structure policies and procedures that are not relevant to an audit and therefore need not be considered. For example, policies and procedures concerning the effectiveness, economy, and efficiency of certain management decision-making processes, such as the appropriate price to charge for its products, or whether to make expenditures for certain research and development or advertising activities, although important to the entity, do not ordinarily relate to a financial statement audit."); SAS 78.12 ("An entity generally has controls relating to objectives that are not relevant to an audit and therefore need not be considered. For example, controls concerning compliance with health and safety regulations or concerning the effectiveness and efficiency of certain management decision-making processes (such as the appropriate price to charge for its products, or whether to make expenditures for certain research and development or advertising activities), although important to the entity, ordinarily do not relate to a financial statement audit."); SAS 94.12 (same but adding: "Similarly, an entity may rely on a sophisticated system of automated controls to provide efficient and effective operations (such as a commercial airline's system of automated controls to maintain flight schedules), but these controls ordinarily would not be relevant to the financial statement audit and therefore need not be considered."). Of course, these subsequent accounting pronouncements, even though they uniformly are consistent with the distinction between administrative and accounting controls set forth in SAS 1, are irrelevant for purposes of statutory interpretation. Even as the AICPA moved the then-authoritative accounting language used virtually verbatim in Section 13(b)(2)(B) of the Exchange Act to an appendix in SAS 55 and then deleted it entirely in SAS 78, Congress never altered the statutory language of Section 13(b)(2)(B). Accordingly, it is the statutory language and legislative intent of the internal accounting controls language of the 1977 Act, rooted so firmly in SAS 1, rather than any subsequent changes in accounting literature, that govern.

23. 1978 ABA Guide at 313.
24. *See, e.g.*, *id.* at 308 (describing both provisions as the "new accounting requirements of the 1977 Act"). The 1978 ABA Guide consistently refers to the two provisions as "accounting requirements," "the accounting provisions," "the accounting standards requirements of the Act," and "the new accounting mandates." *See, e.g.*, *id*. at 308-09, 311-12, 325.
25. Foreign Corrupt Practices Act of 1977, title 1, Pub. L. 95213, 91 Stat. 1494 (1977).
26. *See* 1978 ABA Guide at 308 (referring to the "books, records, and accounts" provision as relating to the "maintenance of financial records"); *id*. at 309 ("Subsection (A) deals with the keeping of financial records; subsection (B) deals with internal accounting controls.").
27. 1976 Senate Report at 11 (emphasis added); *accord* Conference Report at 10 (stating that, when the Conference Committee accepted the House's amendment to add the phrase "in reasonable detail" to the "books, records, and accounts" provision, that amendment "makes clear that the issuer's records should reflect transactions in conformity with accepted

methods of recording economic events and effectively prevent off-the-books slush funds and payments of bribes"); *Unlawful Corporate Payments Act of 1977: Hearings on H.R. 3815 and H.R. 1602 Before the Subcomm. on Consumer, Protection and Finance of the H. Comm. on Interstate and Foreign Commerce*, 95th Cong. 220 (1977) (statement of H. Williams, Chairman, SEC) (testifying that the "books, records, and accounts" provision "means that issuer records must reflect transactions in conformity with accepted methods of recording economic events").

28. 1976 SEC Report at 58 (emphasis added).
29. *Id*. at A-B; *see also id*. at 42 (noting that the "books, records, and accounts" provision "was directed to affirmative acts," such as the use of "substantial off-book funds" for questionable or illegal purposes, "that would distort the accounting records"); Questionable or Illegal Corporate Payments and Practices, 42 Fed. Reg. at 4855 (noting that the "Commission has found that improper and undisclosed expenditures of corporate assets are frequently accompanied by inaccurate maintenance, or outright falsification, of corporate accounting records").
30. 1976 Senate Report at 11.
31. Questionable or Illegal Corporate Payments and Practices, 42 Fed. Reg. at 4856.
32. 123 Cong. Rec. S38379, at 38602 (1977) (statement of Sen. John Tower), *https://www.gpo.gov/fdsys/pkg/GPO-CRECB-1977-pt30/pdf/GPO-CRECB-1977-pt30-1.pdf*.
33. Congress's amendments to the FCPA in 1988 and 1998 also demonstrated the legislature's consistent intent to limit the scope of the "books, records, and accounts" and "internal accounting controls" provisions. While the 1988 amendments expanded the scope of liability under the anti-bribery provision of the FCPA by removing the exclusion of ministerial or clerical government employees from the definition of "foreign official," Congress expressly limited liability under the accounting provisions by defining the terms "reasonable detail" and "reasonable assurances" "in order to clarify that the current standard does not connote an unrealistic degree of exactitude or precision." H.R. Rep. No. 10076, at 917 (1988); *see also id*. at 916 (stating the congressional finding that the accounting standards previously set forth in the 1977 Act were "excessive"). In 1998, Congress again expanded the scope of the anti-bribery provision by adding persons working for or on behalf of a "public international organization" to the definition of "foreign official" and adding "securing any improper advantage" to its enumerated prohibited purposes. S. Rep. No. 105277, at 2-3 (1998). At the same time, however, Congress declined to expand or amend in any way either accounting provision. By so doing, Congress powerfully confirmed the limited accounting and financial statement scope of the "books, records, and accounts" and "internal accounting controls" provisions, even while it expanded the scope of the anti-bribery provision.
34. SAS 1, §§ 320.17, 320.19 (emphasis added).
35. 123 Cong. Rec. S38379, at 38602; *see also* 1978 ABA Guide at 311 (identifying the objectives of the accounting provisions as ensuring that accurate "financial books and records" reflecting "transactions in conformity with accepted methods of recording economic events" are maintained in "such a manner as to permit the preparation of financial statements in conformity with generally accepted accounting principles"); *id*. at 313 (describing the standard for violating the "books, records, and accounts" provision as whether "at the time interim and annual financial statements are required to be prepared [the issuer] is unable to prepare from its books and records financial statements that are in all material respects in conformity with generally accepted accounting principles appropriate in the circumstances"); *id*. (describing the "books, records, and accounts" provision as requiring that "*accounting books of original entry, ledgers* and other *accounting data*," in addition to other "sufficient competent evidential matter" as defined by the AICPA, "be maintained *to the extent reasonably necessary to support the financial statements* and to permit the independent *auditors* to apply *generally accepted auditing procedures*") (emphasis added). False entries in internal company records that are not "reasonably necessary to support the financial statements and to permit the independent auditors to apply generally accepted auditing procedures" do not violate the "books, records, and accounts" provision of the Exchange Act.

36. *See* BNY Order.
37. As discussed earlier, *see supra* note 6, this article does not address the question of whether such internships constitute a "thing of value" for purposes of the anti-bribery provision of the FCPA.
38. BNY Order at 2.
39. *Id.* at 8.
40. Like the other resolutions discussed in this article, there were no allegations that any of the BNY Mellon internships were "no-show" jobs, in which someone was paid without actually having to show up to work. Those situations involve a more classic bribery scheme in which the job is merely a false accounting entry—just like a phony invoice—to cover up funneling cash payments for the benefit of the targeted official. Although the resolutions discussed herein are replete with allegations that some of the interns did not meet the "rigorous criteria" for being hired or were "less than exemplary" employees, *id.* at 6-7, the allegations do not come close to establishing such a direct bribery scheme. Indeed, some of the interns were unpaid. *See, e.g.*, *id.* at 7.
41. *See* JPM Order.
42. *Id.* at 3.
43. *See, e.g.*, *id.* at 3.
44. In contrast, earlier in 2016, in another matter involving efforts to obtain or retain business by offering employment and internships to relatives of foreign officials, the SEC demonstrated precisely what types of internal accounting controls and books, records, and accounts do fall within the ambit of Sections 13(b)(2)(A) and (B). In that matter, the SEC alleged that Qualcomm had violated the anti-bribery provision of the Exchange Act by its offers of employment and internships but expressly did not allege that the failures of Qualcomm's internal controls or the inaccuracies in documents relating to this hiring violated the "internal accounting controls" or "books, records, and accounts" provisions. Rather, the Commission asserted violations of those provisions on the basis of allegedly inadequate accounting controls and inaccurate books, records, and accounts involving the much more traditional—and financial—problems of uncontrolled and falsely documented travel, gift, and entertainment expenditures for foreign officials. *See* In the Matter of Qualcomm Inc., Exchange Act Release No. 3477261, SEC File No. 317145, Order Instituting Cease-and-Desist Proceedings at 9 (Mar. 1, 2016) (charging an anti-bribery violation based on the employment and internship offers but "internal accounting controls" and "books, records, and accounts" violations based on "the provision of travel, gifts, and entertainment to foreign officials without prior pre-approval"); *id.* at 7 (citing only the provision of hospitality packages in the section of the Order relating to internal accounting controls); *id.* at 8 (citing only inaccurate booking of travel and hospitality events and deficient recording of expenditures on meals, gifts, and entertainment in the section of the Order relating to books, records, and accounts).
45. *See* United Order.
46. *See id.* at 2, 4.
47. *Id.* at 2.
48. SAS 1, § 320.14; *see also supra* at 4-5; SAS 1, § 320.19.
49. *See* United Order at 2.
50. *See id.* at 8.
51. *Id.* (emphasis added).
52. 15 U.S.C. § 78m(b)(2)(A).
53. *Disposition Definition*, USLegal.com, *https://definitions.uslegal.com/d/disposition/* (last visited July 20, 2017); *see also* Black's Law Dictionary (10th ed. 2014) (defining "disposition" as "[t]he act of transferring something to another's care or possession, esp. by deed or will; the relinquishing of property"); SEC Form 8K, SEC 873 (0417), Item 2.01 Instructions (requiring written disclosure of the disposition of assets where "[t]he term disposition includes every sale, disposition by lease, exchange, merger, consolidation, mortgage, assignment or hypothecation of assets, whether for the benefit of creditors or otherwise, abandonment, destruction, or other disposition"); *Nat'l Credit Union Admin. Bd. v. RBS Sec., Inc.*, Fed. Sec. L. Rep. (CCH) ¶ 99,229 (D. Kan. July 12, 2016) (holding, in the absence of a statutory definition, that the term "disposed of" should be given its "ordinary meaning" of "transferred or relinquished … to another").
54. *See supra* at 5.
55. *See* United Continental Holdings, Inc. Non-Prosecution Agreement (Jul. 11, 2016), *https://www.justice.gov/usao-nj/file/875351/download* (imposing a $2.25 million penalty); *United States v. Samson*, No. 2:16cr00334 (D.N.J.

2016). *See also* In the Matter of J.P. Morgan Chase & Co., No. 1622BHC, Order to Cease and Desist, at 5 (Fed. Res. Bd. of Gov. Nov. 17, 2016) (Federal Reserve ordering cease and desist pursuant to Section 8 of the Federal Deposit Insurance Act, 12 U.S.C. §§ 1818(b)(1), (3) without relying on the Exchange Act). This further establishes that primary regulators are more than capable of regulating conduct in their industries without the need for the SEC to bring charges on the basis of unsupportable readings of the "internal accounting controls" and "books, records, and accounts" provisions.

56. Congress also did not provide such authority to the Department of Justice, for the same reasons articulated here. The Department of Justice, because it can turn to a far broader set of criminal statutes to prosecute corporate wrongdoing, generally has not found it necessary to push the scope of Sections 13(b)(2)(A) and (B) as expansively as the SEC has. *See, e.g.*, *Samson*, No. 2:16cr00334 (charging violation of 18 U.S.C. § 666(a)(1)(B) but not charging violations of 15 U.S.C. § 78m(b)(2)). Any effort by the Department of Justice to bring criminal charges under the "internal accounting controls" and "books, records, and accounts" provisions on the same basis as the SEC has in the three matters discussed in this article, of course, would be equally unjustifiable.