

Case 8-1

SEC v. Siemens Aktiengesellschaft

On December 15, 2008, the SEC filed a lawsuit against Siemens Aktiengesellschaft (*Aktiengesellschaft* is German for “corporation”), charging the Munich, Germany-based manufacturer of industrial and consumer products with violations of the antibribery, books and records, and internal controls provisions of the FCPA. The SEC has the authority to bring this action because Siemens stock is listed on the NYSE. Siemens agreed to pay a total of \$1.6 billion in disgorgement and fines, which is the largest amount a company has ever paid to resolve corruption-related charges. The company also agreed to pay \$350 million in disgorgement to the SEC. In related actions, Siemens will pay a \$450 million criminal fine to the U.S. Department of Justice (DOJ) and a fine of \$569 million to the Office of the Prosecutor General in Munich, Germany. Siemens previously paid a fine of \$285 million to the Munich prosecutor in October 2007. The SEC released a summary of its litigation in this matter, which is summarized in the following paragraphs.¹

Summary of Litigation

Between March 12, 2001, and September 30, 2007, Siemens violated the FCPA by engaging in a widespread and systematic practice of paying bribes to foreign government officials to obtain business. Siemens created elaborate payment schemes to conceal the nature of its corrupt payments, and the company’s inadequate internal controls allowed the conduct to flourish. The misconduct involved employees at all levels, including former senior management, and revealed a corporate culture long at odds with the FCPA.

During this period, Siemens made thousands of payments to third parties in ways that obscured the purpose for, and the ultimate recipients of, the money. At least 4,283 of those payments, totaling approximately \$1.4 billion, were used to bribe government officials in return for giving business to Siemens around the world. Among others, Siemens paid bribes on transactions to design and build metro transit lines in Venezuela; metro trains and signaling devices in China; power plants in Israel; high-voltage transmission lines in China; mobile telephone networks in Bangladesh; telecommunications projects in Nigeria; national identity cards in Argentina; medical devices in Vietnam, China, and Russia; traffic control systems in Russia; refineries in Mexico; and mobile communications networks in Vietnam. Siemens also paid kickbacks to Iraqi ministries in connection with sales of power stations and equipment to Iraq under the Oil for Food Program of the United Nations (UN). Siemens earned over

\$1.1 billion in profits on these transactions. An additional 1,185 separate payments to third parties were made totaling approximately \$391 million. These payments were not properly controlled and were used, at least in part, for illicit purposes, including commercial bribery and embezzlement.

From 1999 to 2003, Siemens’s Management Board was ineffective in implementing controls to address constraints imposed by Germany’s 1999 adoption of the Organization for Economic Co-operation and Development (OECD) anti-bribery convention that outlawed foreign bribery. The Management Board was also ineffective in meeting the U.S. regulatory and antibribery requirements that Siemens was subject to following its March 12, 2001, listing on the NYSE. Despite knowledge of bribery at two of its largest groups—Communications and Power Generation—top management was tone-deaf to the internal environment it had developed and created a corporate culture in which bribery was tolerated (and even rewarded) at the highest levels of the company. Employees obtained large amounts of cash from cash desks, which were sometimes transported in suitcases across international borders for bribery. Written authorizations for payments were removed later to eradicate any permanent record. Siemens used numerous slush funds, off-books accounts maintained at unconsolidated entities, and a system of business consultants and intermediaries to facilitate the corrupt payments.

Siemens failed to implement adequate internal controls to detect and prevent violations of the FCPA. Elaborate payment mechanisms were used to conceal the fact that bribe payments were made around the globe to obtain business. False invoices and payment documentation were created to make payments to business consultants under false business consultant agreements that identified services that were never intended to be rendered. Illicit payments were falsely recorded as expenses for management fees, consulting fees, supply contracts, room preparation fees, and commissions. Siemens inflated contracts with the United Nations (UN), signed side agreements with Iraqi ministries that were not disclosed to the UN, and recorded the after-sale-service-charge (ASSF) payments as legitimate commissions despite UN, U.S., and international sanctions against such payments.

In November 2006, Siemens’s current management began to implement reforms to the company’s internal controls. These reforms substantially reduced, but did not entirely eliminate, the corrupt payments. All but \$27.5 million of the corrupt payments occurred before November 15, 2006. The company conducted a massive internal investigation and implemented an amnesty program to its employees to gather information.

The success of Siemens’s bribery system was maintained by lax internal controls over corruption-related activities and an acceptance of such activities by members of senior

¹*Securities and Exchange Commission v. Siemens Aktiengesellschaft*, Case 1:08-cv-02167, Litigation Release No. 20829, Accounting and Enforcement Release No. 2911, December 15, 2008, www.sec.gov/litigation/litreleases/2008/lr20829.htm.

management and the compliance, internal audit, legal, and finance departments. Siemens violated Section 30A of the Securities Exchange Act of 1934 by making illicit payments to foreign government officials in order to obtain or retain business. Siemens violated Section 13(b)(2)(B) of the Exchange Act by failing to have adequate internal controls to detect and prevent the payments. Siemens violated Section 13(b)(2)(A) of the Exchange Act by improperly recording the payments in its books.

Without admitting or denying the commission's allegations, Siemens consented to the entry of a court order permanently enjoining it from future violations of the Exchange Act; ordering it to pay \$350 million in disgorgement of wrongful profits, which does not include profits factored into Munich's fine; and ordering it to comply with certain undertakings regarding its FCPA compliance program, including an independent monitor for a period of four years. On December 15, 2008, the court entered the final judgment. Since being approached by SEC staff, Siemens has cooperated fully with the ongoing investigation, and the SEC considered the remedial acts promptly undertaken by Siemens. Siemens's massive internal investigation and lower-level-employee amnesty program were essential in gathering facts regarding the full extent of Siemens's FCPA violations.

Charges Against the Management Board

The following charges were made against Siemens's Management Board:

1. The board was ineffective in meeting the U.S. regulatory and antibribery requirements that Siemens was subject to following its listing on the NYSE on March 12, 2001.
2. The board failed to adopt meaningful compliance measures, failed to staff Siemens's compliance function adequately, and, at times failed to adopt reasonable recommendations designed to ensure compliance procedures at the company.
3. The company failed to respond to red flags, including ignoring substantial cash payments in Nigeria by senior-level employees within one of its business groups and ignoring Siemens's outside auditor KPMG's identification of approximately \$5.81 million in cash that was brought to Nigeria by a Siemens employee. The FCPA compliance report prepared on the foregoing matters in November 2003 by Siemens's then-CFO did not lead to any disciplinary actions against those employees involved in the bribery, and the report was not provided to or discussed with the Management Board or the company's audit committee.

Illicit Payment Mechanisms Used to Pay Bribes

Siemens made thousands of payments to third parties in ways that obscured the purpose for, and ultimate recipient of, the money. The principal mechanisms used to facilitate illicit

payments were business consultants, payment intermediaries, slush funds, cash, and intercompany accounts.

Through its use of business consultants and payment intermediaries, Siemens funneled more than \$982.7 million to third parties, including government officials. Business consultants were typically hired pursuant to business consultant agreements, contracts that on their face obligated Siemens to pay for legitimate consulting services. In reality, many business consultant agreements were shams, in that the consultants performed no services beyond funneling bribes. One business group had specific instructions on how to use a "confidential payment system" to conceal payments to business consultants. Payment intermediaries were additional entities and individuals through which Siemens funneled bribes. In many cases, Siemens would pay the intermediary an amount and simultaneously direct that the money be transferred to a third-party bank account, less a small portion as the intermediary's fee.

Siemens also funneled more than \$211 million through slush funds for use as bribes. Slush funds were bank accounts held in the name of current or former senior Siemens employees, third parties, or affiliated entities. These payments were made before September 30, 2004. The most notable slush funds were maintained by a former group (i.e., consolidated entity) manager who has been convicted in Germany for his role in the payment of bribes to foreign officials, which included several slush funds held in the name of U.S. shell companies.

Siemens also used cash and cash equivalents to funnel more than \$160.4 million to third parties. Its employees used "cash desks" maintained by the Siemens Real Estate Group to obtain large amounts of cash to pay bribes. Often, employees would obtain hundreds of thousands of dollars and, at times, even \$1 million in various currencies from the cash desks in Germany. At times, the cash was then stored in safes maintained by Siemens employees to ensure ready access to cash to pay bribes.

As early as 2004, a Siemens corporate financial audit employee raised concerns about the use of intercompany accounts. He was phased out of his job and assigned to work on "special projects" from his home until leaving the company in 2005. Siemens thereafter began closing some of the accounts and eventually closed all of them.

Another type of internal account that employees abused was Siemens internal commission accounts. These balance-sheet accounts were intended to be used to record commissions at a business group earned on transactions with other Siemens entities. These accounts were used to make third-party payments. Many of the intercompany account payments and the internal commission account payments were done manually to bypass Siemens's automated payment system. The manual payments, executed through the system, did not require the submission of documentation in support of a payment. Siemens used a host of other schemes to make more than \$25.3 million in payments to third parties. In particular, Siemens used sham supplier agreements, receivables, and other write-offs to generate payments.

In total, Siemens made bribery payments directly or indirectly to foreign government officials in connection with at least 290 projects or individual sales involving business in a variety of countries.

Siemens Failed to Maintain Its Books, Records, and Internal Controls

Siemens failed to implement adequate internal controls to comply with the company's NYSE listing, including the detection and prevention of violations of the FCPA. As already stated, Siemens made thousands of payments to third parties in ways that obscured the purpose for, and the ultimate recipients of, the payments. Despite a policy that required two signatures on company documents to authorize transactions, a significant number of business consultant agreements were entered into and a significant number of payments were authorized in violation of the policy.

Siemens paid approximately \$1.4 billion in bribes to foreign government officials. Doing so involved the falsification of Siemens's books and records by employees throughout the company. Specifically, Siemens failed to keep accurate books and records by (1) establishing and funding secret, off-books accounts; (2) establishing and using a system of payment intermediaries to obscure the source and destination of funds; (3) making payments pursuant to business consultant agreements that inaccurately described the services provided; (4) generating false invoices and other false documents to justify payments; (5) disbursing millions in cash from cash desks with inaccurate documentation authorizing or supporting the withdrawals; (6) concealing the identity of persons authorizing illicit payments; (7) recording illicit ASSF payments as legitimate commissions in Oil for Food transactions; (8) falsifying UN documents in connection with the Oil for Food program; and (9) recording bribes as payments for legitimate services.

Siemens failed to establish controls over cash disbursements, allowed manual payments without documentation, and failed to ensure the proper use of intercompany accounts. In addition, the company failed to establish an effective central

compliance function. The compliance office lacked independence and was severely understaffed. Siemens's tone at the top was inadequate for a law-abiding entity, and employees engaged in bribery and other misconduct on behalf of the company were not disciplined adequately. Siemens also failed to conduct appropriate antibribery and corruption training.

Questions

1. Evaluate the ethics of actions taken by Siemens with respect to Josephson's Six Pillars of Character and virtue-based decision making, as discussed in Chapter 1.
2. Under the German Criminal Code, much like the U.K. Bribery Act, all bribes are prohibited including facilitating payments. The Foreign Corrupt Practices Act (FCPA) in the U.S. makes a distinction between the two and permits facilitating payments made to induce a government official to carry out her designated responsibilities. From an ethical perspective, which of these two approaches are more consistent with virtue theory?
3. Comment on the following statement from an ethics perspective: Companies that make the mistake of trying to follow the bottom limits of legal behavior without championing ethics should learn from the Siemens case that once a culture of taking short cuts and ignoring values is in place, it is only a matter of time before employees cross the line into illegal conduct.

Optional Question

4. Review the 13 cases on bribing foreign government officials described in the SEC complaint referenced below.² Summarize the accounting issues involved in each case and explain how the payments described violated the FCPA.

²*Securities and Exchange Commission v. Siemens Aktiengesellschaft*, Case 1:08-cv-02167, Litigation Release No. 20829, Accounting and Enforcement Release No. 2911, December 15, 2008, www.sec.gov/litigation/complaints/2008/comp20829.pdf.