

## **RESPONSES TO THE CONSULTATION PAPER ON THE REVIEW OF THE OECD ANTI-BRIBERY INSTRUMENTS**

### **Comments from Grant Thornton International**

Grant Thornton International appreciates the opportunity to comment on the OECD's *Consultation Paper, Review of the OECD Instruments on Combating Bribery of Foreign Public Officials in International Business Transactions Ten Years After Adoption* (Consultation Paper).

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We commend the work that the OECD Working Group has done since the adoption of the *Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (OECD Anti-Bribery Convention)*.

Grant Thornton International believes we can offer comments and recommendations in connection with the Consultation Paper's three external audit issues identified in the Working Group's Mid-Term Study:

#### ***Whether the Requirement of an External Audit Applies to an Adequate Spectrum of Companies***

The requirement for an entity to have an external audit can only be determined by those charged with governance; for example, to comply with a request from a bank; a requirement by a government; the need of a credit professional; or the interests of an investor. Audited financial statements have become the accepted means by which businesses provide information on their financial affairs to all interested parties. If none of the circumstances above exist for an entity, there may not be a need for an entity to have an external audit.

Grant Thornton International believes that to expand an external audit requirement to all entities may not provide adequate benefits compared to the cost of that audit, especially since an external audit is not a guarantee that all instances of fraud or bribery would be detected. We believe there is a far greater benefit to be achieved if entities were required to maintain adequate internal controls to detect bribery and fraudulent transactions at their source.

#### ***Whether there is an Adequate Obligation for Reporting to the Competent Authorities***

We note that the Consultation Paper states that the Working Group's Mid-Term Study indicated that very few cases of foreign bribery have been detected through the actions of external auditors. The Mid-Term Study indicates reasons for this could be that there is no legal requirement for external auditors to report bribery; external auditors generally feel constrained by confidentiality rules; and external auditors do not want to be considered whistleblowers.

Grant Thornton International believes, however, that there is an adequate obligation under international standards on auditing (ISAs) for external auditors to address the issue of fraud (including bribery) in their audits of financial statements. We highly recommend promoting adoption of the ISAs worldwide.

ISA 240, *The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements*, provides guidance to external auditors on their responsibility to consider fraud (including bribery) in an audit of financial statements, and how to distinguish fraud from error. ISA 240 states that the primary responsibility for the prevention and detection of fraud rests with management and those charged with governance of the entity. The external auditor's objective in the audit of financial statements is to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. There is an inherent risk in performing an audit that some material misstatements of the financial statements, whether by fraud (including bribery) or error, will not be detected, even though the audit is properly planned and performed in accordance with the professional auditing standards.

Under existing professional standards, external auditors must handle client information with care and confidentiality. The Code of Ethics for Professional Accountants (Code) issued by the International Federation of Accountants (IFAC) presently requires external auditors to "respect the confidentiality of information acquired as a result of professional and business relationships and . . . not disclose any such information to third parties without proper and specific authority unless there is a legal or professional right or duty to disclose." (Section 100.4(d)) However, a professional accountant may be required to disclose confidential information or disclose such information when the disclosure is permitted or required by law. For example, as noted in ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, the auditor's duty of confidentiality is overridden by an individual country statute, law or other supervisory authorities.

In the United States, Congress enacted the Private Securities Litigation Reform Act of 1996 (the Reform Act), which came about as a reaction to the increase in vexatious, often meritless, class action lawsuits filed in response to a drop in a stock's value and alleging that some disclosure (or failure to make disclosure) by an issuer of the security was either false or misleading. Defendants in these suits frequently included the issuer's external auditor. The Reform Act included procedural and substantive provisions aimed at discouraging these types of lawsuits. Also, in order to encourage disclosure to the investing public of possible false or misleading information, "safe harbors" were provided to management in order for them to provide more forward-looking information that investors were interested in.

Grant Thornton International believes that providing a "safe harbor" regulation for external auditors to address legal liability concerns in disclosing fraud and bribery would benefit investors as well as external auditors. A safe harbor does not immunize an auditor against a substandard audit; but may provide external auditors with more guidance in reporting cases of possible fraudulent activity or bribery.

***Whether the Standard is Adequate for Triggering a Report of Foreign Bribery Either Internally or Externally to the Competent Authorities***

As noted above, the external auditor's objective in the audit of financial statements is to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. This opinion is not a guarantee. ISA 320, *Audit Materiality*, indicates that auditors may set various levels of materiality during their audit testing of the financial statements based on risk of misstatements, and in relation to classes of transactions, account balances and disclosures (paragraph 7) in order to express their opinion on the financial statements as a whole. ISA 315, *Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement*, and ISA 240, *The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements*, also provide the external auditor with guidance to understand the entity, including management and those charged with governance, its environment and controls, and how to distinguish fraud from error. Legal and regulatory requirements also affect the level of materiality used in performance of audit procedures. Professional judgment by the external auditor is required in order to assess the risk of material misstatement whether

due to fraud, bribery or error in the financial statements, and in developing procedures to reduce the risk of fraud, bribery or error to an acceptable level. As also noted above, there is always an inherent limitation that fraud, bribery or error will not be detected in performing an audit and rendering an opinion on the financial statements taken as a whole.

In connection with reporting internally, under ISA 240, *Consideration of Laws and Regulations in an Audit of Financial Statements*, the external auditor is required to report noncompliance with laws or regulations (including fraud or bribery) to management or those charged with governance for all matters except those that are “clearly inconsequential or trivial.” If the auditor suspects noncompliance by senior management, the auditor is required to report to a higher level of authority within the entity.

Grant Thornton International supports efforts to strengthen the requirements of those charged with governance of an entity, in their obligations to report bribery to the appropriate authorities and to develop tools to support entities in the task of implementing anti-bribery policies and programs.

We also believe the professional auditing standards provide the appropriate tool and set an appropriate threshold for external auditors in their consideration of reporting fraud or bribery externally to competent authorities. We do not believe auditors should be responsible to report immaterial or inconsequential misconduct.

We would suggest that the Working Group consider implementing an appropriate outside reporting model for bribery, similar to the enforcement tool in the United States. Section 10A of the Securities Exchange Act of 1934 (the Act) requires accounting firms to utilize audit procedures designed to detect illegality and to bring material illegal acts they detect during the course of an audit to the attention of senior management and the entity’s audit committee. If management does not take proper remedial action, and the illegal acts have a material effect on the financial statements of the entity, the external auditor must report these illegal acts directly to the board of directors and the board of directors must then notify the Securities and Exchange Commission. With this type of requirement, entities would be prudent to protect themselves by understanding an external auditor’s reporting requirements, and by responding with proper remedial action to information uncovered during the course of an audit or otherwise indicating that illegal acts of bribery may have occurred.

The United States Congress also used the Sarbanes-Oxley Act of 2002 (SOX) to add a number of amendments to Section 10A of the Act relating to stricter standards for accounting firms and audit committees to report illegal acts. SOX represents a major breakthrough in the United States in establishing whistleblower rights as well. SOX’s whistleblower provisions represent an opportunity for publicly traded entities to use whistleblowers as an internal early warning system for illegal conduct and other wrongdoing. An effective internal whistleblower program will allow an entity to identify illegal conduct before it occurs or before it becomes catastrophic, correct the conduct internally, increase accountability, build confidence in the entity among shareholders, employees and consumers, and preclude the wrongdoing from becoming a major focus of government enforcement agencies. We believe requiring stronger controls within entities and making “those at the top” responsible for reporting fraud and bribery is the appropriate first step in combating these issues.