

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

Comments from KPMG International

KPMG International¹ ('KPMGI') welcomes the opportunity to provide comments in response to the OECD's consultation paper concerning Review of the OECD Instruments on Combating Bribery of Foreign Public Officials in International Business Transactions Ten Years after Adoption ('Consultation Paper').

KPMGI strongly supports the objectives of the OECD in its fight against foreign bribery. We consider that the OECD has been extremely effective in raising global awareness of this issue. We are pleased to have the opportunity through this response to the Consultation Paper to raise issues with the OECD aimed at further enhancing the effectiveness of the OECD's anti-bribery instruments.

In line with KPMG's values and publicly stated commitment to integrity, and lawful and ethical behaviour, last year KPMGI signed the World Economic Forum, Partnering Against Corruption – Principles for Countering Bribery ('PACI Principles'). Our comments in this submission reflect this commitment.

Our comments are also consistent with the key principles that underlie the roles and responsibilities of management and auditors with respect to the preparation and audit of financial statements. The appendix to this letter provides an overview of the responsibilities of management and the auditor in respect of compliance with laws and regulations concerning anti-bribery.

Against this background, this submission now turns to some specific elements of the Consultation Paper, beginning with three issues relating to the independent external audit.

Companies subject to external audit (paragraph 107)

This issue concerns whether the requirement of an external audit applies to an adequate spectrum of companies. In particular, the OECD is concerned as to whether a standard for external audit that includes private companies should be imposed.

The purpose of the external audit is for the auditor to express an opinion on whether the financial statements, when taken in their entirety and in all material respects, give a true and fair view. An audit of financial statements is not designed to test for compliance with all laws and regulations other than to the extent such compliance may materially impact the financial statements (e.g. certain tax laws).

It is therefore possible that an auditor will not identify non-compliance with laws and regulations. This is particularly relevant to non-compliance arising from bribery since bribes are often deliberately misrepresented as a legitimate expense if they are actually recorded in the accounts and the individual amounts involved may not be material to the financial statements.

Within this context, we consider that the incremental benefit to be obtained from an anti-bribery perspective in imposing a uniform requirement on the scope of companies to be subject to external audit may be minimal. It would most likely be significantly outweighed by the detriment that would come from

¹ Throughout this document, "KPMG International" means the Swiss cooperative, KPMG International, with which the independent member firms of the KPMG network are affiliated and 'KPMG' refers to the KPMG network of independent member firms, or to one or more of these firms. KPMG International provides no client services.

restricting the flexibility of allowing countries to consider the impact on their economies and capital markets in terms of cost, risk and efficiency of expanding the scope of companies subject to external audit.

Reporting to the competent authorities (paragraphs 108 - 110)

The concern expressed in the Consultation Paper is that there is an inconsistent application of reporting obligations for auditors, and that in particular reporting by external auditors to outside authorities is prohibited or excluded in practice due to the application of confidentiality requirements.

It is KPMGI's view that the current framework, established under International Standard on Auditing (ISA) 250, provides an appropriate mechanism, consistent with the role of the external auditor, for reporting of non-compliance to management and those charged with governance and, if appropriate, external authorities.

ISA 250 requires the auditor, to communicate with those charged with governance, as soon as practicable, or to obtain audit evidence that those charged with governance are appropriately informed, regarding non-compliance with laws and regulations that comes to the auditor's attention. The auditor need not do so only for matters that are clearly inconsequential or trivial.² If the non-compliance is believed to be intentional and material, the auditor should communicate the finding without delay.³

If the auditor suspects that members of senior management, including the board, are involved in non-compliance then the auditor should report the matter to the next higher level of authority at the entity, if it exists, such as an audit committee or a supervisory board.⁴

The auditor will then consider the impact of the non-compliance on the financial statements, and what impact this should have on the auditor's report.⁵ If, in the auditor's view (ordinarily based on legal advice), the entity has not taken appropriate remedial action in response to the non-compliance, the auditor may conclude that withdrawal from the engagement is necessary. This is the case even where non-compliance is not material to the financial statements.⁶

The auditor's duty of confidentiality would normally preclude reporting non-compliance to a third party. However, in certain circumstances, that duty may be overridden by local laws or statutes.⁷

This reporting framework is consistent with the role of management and auditors. It is the primary responsibility of management to ensure that it complies with laws and regulations. It should therefore be the primary responsibility of an entity and its management to report non-compliance with anti-bribery laws and regulations to competent authorities. It is also consistent with the role and responsibilities of the auditor in respect of compliance with laws and regulations.

² ISA 250, paragraph 32.

³ ISA 250, paragraph 33.

⁴ ISA 250, paragraph 34.

⁵ ISA 250, paragraphs 35 – 37.

⁶ ISA 250, paragraph 39.

⁷ See for example, section 333 of the UK Proceeds of Crime Act 2002, section 10A of the US Securities Exchange Act 1934.

Standard for triggering a report (paragraphs 105 – 111)

The Consultation Paper refers to the fact that many parties to the Convention impose a materiality requirement on the duty to report indications of possible illegal acts or externally to competent authorities. As a result, the Consultation Paper contends that the application of materiality thresholds could result in the non-reporting of indications of bribery.

In addition, the Consultation Paper provides that the threshold that must be met in order for a fraudulent accounting act of omission to be considered ‘material’ is often vague.

As noted earlier, in accordance with International Standards on Auditing, the auditor must report to those charged with governance, all non-compliance that comes to the auditor’s attention other than matters that are clearly inconsequential or trivial.⁸ This threshold is significantly lower than the level of financial statement materiality.

In respect of reporting any non-compliance with laws and regulations to competent authorities, as noted above, our view is that the primary obligation to report such acts should rest with management and those charged with governance.

In the event a country seeks to impose a requirement for reporting on external auditors, this should include clear criteria for such reporting in terms of the types of matters that should be reported and to whom.

Facilitation payments (section 1.3)

We agree with the OECD view that any exception for small facilitation payments in country legislation should be clear and should not exceed the definition in the OECD anti-bribery instruments.

Solicitation payments (paragraph 12)

The Consultation Paper notes that the Convention focuses specifically on the ‘supply side’ of the bribery transaction. It states that some parties have incorporated defences into the offence of bribing a foreign public official that take into account, at least to a certain degree, solicitation by the foreign public official.

We do not consider any such defence supportable. It seems inconsistent with the objective of the OECD’s anti-bribery instruments. Further, the fact that such defences are available seems to support the OECD’s position that there is an inconsistent level of awareness across parties by public agencies or institutions directly and indirectly involved in implementing the Convention.⁹

Private sector bribery (section 1.7)

This section is concerned with whether the OECD should extend the scope of the OECD anti-bribery instruments to include bribery in the private sector. The Working Group notes that ‘this issue is not so far in its mandate and is cautious about extending its mandate to cover this issue.’¹⁰

⁸ ISA 250, paragraph 32.

⁹ See paragraph 79.

¹⁰ See paragraph 21.

We agree with the OECD position that permissiveness towards bribery in the private sector may result in a business climate conducive to foreign bribery. This will be of particular concern in countries where there is a large private sector, and where there is a lack of clarity between public and private sector officials (for example in an infrastructure sector where there has been significant privatisation). We note that the PACI Principles, to which KPMGI is a signatory, make no distinction between public and private bribery.

However, we also agree with the OECD that, for the time being, it may be more reasonable for the OECD to focus its efforts on successful implementation of the prohibition against bribery of foreign public officials.

KPMGI would welcome involvement in any future discussions concerning proposals to extend the OECD's anti-bribery instruments to encompass private sector bribery.

Confiscation (section 3.1)

The Consultation Paper notes that Article 3.3 of the Convention requires that parties to the Convention take necessary measures to provide that the bribe and the proceeds of bribing a foreign official, or property that corresponds to the value of such proceeds, are subject to seizure and confiscation, or that monetary sanctions of comparable effect are applicable.

It notes that at the time of the Mid-Term Study¹¹ there were no examples of the confiscation of the bribe or the proceeds of bribing a foreign public official in parties to the Convention.

The Consultation Paper states that this is likely due to two factors – complexities and uncertainties regarding the quantification of such sums.

KPMGI agrees that while such quantification is a difficult issue, forensic accountants are generally capable of quantifying such sums. We agree with the OECD that confiscation is likely to be a highly effective deterrent and sanction. Should the OECD want to further encourage the use of such sanctions it may wish to consider whether there is scope for providing more helpful guidance to parties on such calculations. KPMG would be pleased to offer its assistance in any such discussions.

Internal controls (section 4.1)

We are in agreement with the OECD's comments regarding the importance of internal company controls. Adequate internal controls, including standards of conduct and compliance programs, creation of monitoring bodies independent of management and adequate channels of communication for reporting non-compliance are all essential to the ability of entities of all sizes to mitigate bribery risks.

As a signatory to the PACI Principles we also strongly endorse the OECD's encouragement of companies to voluntarily adopt controls using, for example, the PACI Principles, ICC Rules and Recommendations or OECD standards on internal controls.

¹¹ OECD, Mid-Term Study of Phase 2 Reports – Application of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 1997 Recommendation on Combating Bribery in International Business Transactions.

APPENDIX - OVERVIEW OF THE RESPONSIBILITIES OF MANAGEMENT AND THE AUDITOR IN RESPECT OF LAWS AND REGULATIONS CONCERNING ANTI-BRIBERY

International Standards on Auditing (ISAs) are standards that KPMG member firms are required to follow in conducting an audit of financial statements. The ISAs do not specifically address the auditor's responsibilities with respect to laws and regulations concerning anti-bribery. ISA 250, Consideration of Laws and Regulations in an Audit of Financial Statements, however, addresses the auditor's responsibility with respect to consideration of laws and regulations in general. The ISAs also describe management's responsibilities in these areas.

Further, as part of its "clarity project" the International Auditing and Assurance Standards Board (IAASB) is in the process of revising the ISAs so that they more clearly explain the premise and assumptions on which an audit of financial statements is based.

After following appropriate due process, the IAASB approved a final "clarified" version of ISA 250 on March 14. This version emphasizes the following key principles that are also included in extant ISA 250:

- It is management's responsibility, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with laws and regulations. The responsibility for the prevention and detection of non-compliance rests with management.
- It is the auditor's responsibility to express an opinion on whether the financial statements give a true and fair view or are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.
- In expressing such an opinion, the auditor's objective is to detect material misstatements in the financial statements. Although the ISAs require the auditor to give consideration to laws and regulations, the auditor's primary objective is not to identify areas of non-compliance with laws and regulations.

Revised ISA 250 states that the objectives of the auditor with respect to the consideration of laws and regulations are:

- To obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements. Examples of laws and regulations that include such provisions are certain tax and pension laws and regulations.
- To perform audit procedures specified in the ISA that are designed to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements. Examples of such laws and regulations include laws that are fundamental to the operating aspects of a business such as the terms of an operating license, laws that are relevant to

an entity's ability to continue its business such as regulatory solvency requirements, or laws that may impose material penalties such as environmental regulations; and

- To respond appropriately to non-compliance or suspected non-compliance with laws and regulations identified during the audit. The ISA sets out the procedures and communications that the auditor needs to carry out in order to respond appropriately.

Consistent with the principles underlying the role and responsibilities of management and the auditor, the auditor's procedures relate to understanding the act, the circumstances in which it has occurred and considering the possible effect on the financial statements and on the audit. The ISA sees it as the role of management to communicate non-compliance to appropriate third parties, unless the auditor is required by law to communicate directly with such parties.