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

Comment from BDO Global Coordination Office

BDO International is the fifth largest international audit network with over 600 offices in BDO Member Firms located across 110 countries including all 30 member countries of the OECD and the 7 additional countries who have signed this particular Convention (according to page 4, footnote 1 of the Consultation Paper).

The network has been in existence since 1963 with a number of the current BDO Member Firms in existence for many years prior to that. The network is coordinated by the BDO Global Coordination Office located in Brussels, Belgium and I am making this submission as global coordinator of BDO involvement in regulatory and public policy matters. All BDO Member Firms are legally separate and independent entities in their own countries and provide services to clients on their own account. Neither BDO International nor BDO Global Coordination BV provides any services to clients.

Introduction

The world has changed enormously in the ten years 1997-2007 including the particular environment in which individual audit firms and global networks operate. The various circumstances surrounding the concentration of what were then known as the Big 8 audit networks, into [initially] five such networks and the subsequent demise of Arthur Andersen leaving just the "Big 4", resulted in significant changes for the profession. These included the disappearance of self-regulation in most developed countries, increased government or independent oversight, a greater focus on professional ethics and enhanced quality control procedures within audit firms, greater independence requirements and significantly increased transparency about many aspects of the structure and workings of audit firms. Whilst not all of these developments occurred to the same extent or simultaneously across all developed countries, it is fair to say that the environment in which external audit firms now operate is completely different to 1997 in almost every jurisdiction. It is the view of BDO International and most commentators that almost all of these changes are for the better and have increased confidence in the audit profession.

The introduction of management attestation as to the existence and efficacy of internal controls (audited or further attested to by the external auditors in some jurisdictions) has enhanced corporate governance and widened the role of the external auditor beyond the audit of the historical financial statements of a company [in some territories].

New professional ethics standards, continuing convergence around more globally accepted accounting and audit standards, and additional anti-money laundering legislation in many countries (e.g. European Union Member States) have also heightened the role, expectations and relevance of the profession in the view of most commentators.

Against this backdrop, it is appropriate and timely that the [external] audit profession should be invited to make comment on the Consultation Paper given the number of references to the profession in the Consultation Paper itself, the original Convention, the Revised 1997 Guidelines and Section 8 of the Mid Term Study of Phase 2 reports. It is not clear to us how involved the audit profession **as a whole** was in the process that framed the initial Convention, the Revised Guidelines or the Mid Term Study.

It is the belief of BDO International that the submissions in relation to the instruments by all interested stakeholders at this time will greatly aid the overall goal of the OECD Working Group to "…determine what steps might be taken to strengthen their implementation". We commend your efforts in this regard.

General impressions concerning the effectiveness and implementation of the OECD anti-bribery instruments over the last ten years[1]

Although it is difficult to comment on many of the issues affected by the issues of anti-bribery instruments due to their necessarily legalistic nature, it is the impression of this network that progress has been made in many areas of combating bribery of foreign public officials in the 10 year period referred to. It is clear also that much work remains to be done if further progress is to be made across the signatories of the Convention. Furthermore, the rise of particular countries in economic terms since 1997 has led to a significant gap in the "territoriality" of the instruments given the significance of emerging market countries including those that have become known as the *BRIC* countries, viz., Brazil, Russia, India and China. The non-applicability of the OECD instruments in these and other new economic forces risks making ineffective the Convention and associated instruments given the gap in geographical coverage apparent as a consequence. Some might argue that it results conceivably in giving companies from [or trading in] those countries a "competitive advantage" over those from companies located [or trading in] Convention signatories. At the very least, we would speculate as to whether the goals of the Convention can be attained if such burgeoning economic forces remain outside the remit of the OECD initiatives in this area. We note the appeal of the OECD Council to non-members to adhere to the 1997 Recommendation and to participate in follow up etc[2]

Additional insights on specific issues raised in this Consultation Paper

We have reviewed all of the relevant documents very carefully and although outside the area of expertise of BDO International, it is clear that further progress is imperative in areas addressed in Part 1, 2 and 3 of the Consultation such as;

- varying criminal law definitions and prosecution considerations,
- information exchange between the prosecution authorities of jurisdictions,
- harmonization of domestic and foreign bribery legal responses within a country,
- greater coordination of anti-bribery legislation with anti-money laundering legislation within a country,
- harmonisation of requirements, definitions and responsibilities in the areas of fraudulent accounting as between signatory countries,
- raising the awareness of state, legal, accounting and business parties in relation to the requirements of the Convention and bribery of foreign public officials generally.

We are sure that these types of issues are central to many if not all OECD Conventions or other pronouncements and are at the core of its recurring contact with OECD Parties and Convention signatories in relation to effective implementation of this Convention. We are aware that it is *functional equivalence* and not absolute equivalence that is sought in relation to issues such as those mentioned above.

---

[1] Viz., The Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, the 1997 Revised Recommendations of the Council on Combating Bribery in International Business Transactions and the 1996 Recommendation of the Council on the Tax Deductibility of Bribes to Foreign Public Officials.

[2] Commentary para 37 re Article 13 on the Convention.

Regarding specific aspects of the Consultation on which BDO International would be concerned and better positioned to comment, we make the following observations.

Fraudulent accounting (Part 2, Section 8).

We note the OECD observation that there has been "an improvement in the rules regarding the maintenance and records in virtually all of the Parties to the Convention…….[which] should enhance the detection and deterrence of bribery of foreign public officials"[3]. In keeping with the audit profession's general commitment to converged accounting and auditing standards globally, we would support moves towards greater "standardisation" or *functional equivalence* in this area. This would include a more common definition of what constitutes fraudulent accounting, the spectrum of companies to whom it would apply, the parties who would be held liable where there was such an offence committed etc.

We would like to distinguish between the legal concept of "materiality" thresholds for application of fraudulent accounting purposes and the similar "materiality" assessments used by external auditors when carrying out their function of statutory audit of the financial statements. The former is a legal issue varying in its measurement as between jurisdictions' legal codes and to a large extent, impacting primarily on the scope and operability of the law in this area, in that jurisdiction. Materiality for an external auditor is a professional auditing concept which involves the exercise of professional judgement within the framework of accepted International Standards on Auditing (ISAs) or equivalent Generally Accepted Auditing Standards (GAAS, e.g. US GAAS). This distinction will be important in relation to comments we will make later regarding any reporting obligation that might exist for external auditors in connection with the possible [foreign] bribery matters.

Furthermore, we disagree with the inclusion of "auditors" in sub-section 67 of this section as being one of the parties "…responsible for the maintenance of books and records." If this observation is taken to mean or include external auditors, then it indicates a critical and significant misunderstanding of the role of external auditors which could impact on the outcome of the consultation. The external auditor has no role in relation to the maintenance of a company's books and records which is the sole responsibility of the management of the company in every jurisdiction that we are aware of. Indeed, any involvement or association by the external auditor with the maintenance of those books and records gives rise to independence questions over the auditor and is fully addressed in the ethical guidance issued by IFAC, who could be said to be the *de facto* standard setter for the overwhelming majority of auditors worldwide. Consequently any proposal that is grounded on supposing that the external auditor has a responsibility or role to play in relation to those books and records is inherently flawed.

Role of Internal Company Controls and External Audits (Part 3, Section 4)

We endorse the comments in subsection 96 which states that"….sound principles of corporate governance and management to those principles form the foundation for the prevention of bribery" and in fact we would add that these form the primary defences against all types of corruption and fraud within a company. It is however arguable as to whether the subsequent statement that external audit is an "integral component of a company's compliance system" is valid.

International Standard on Auditing 200 (ISA 200) indicates *inter alia* "…the responsibility for the preparation and presentation of the financial statements…is that of the management of the entity, with oversight of those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

[3] Consultation Paper, Part 2, Section 8, sub-section 65

The ISA also states that ”Management is also responsible for ..designing, implementing and maintaining internal control relevant to the preparation of financial statements that are free from material misstatement, whether due to fraud or error”.

This fundamental technical guidance, produced by the International Auditing and Assurance Standards Board of IFAC, forms the basis on which external auditors carry out their duty as external auditors. The auditors' duties in relation to fraud are set out in a number of ISAs including ISA 240[4] and ISA 250[5] which are germane to the central issue here i.e. what are [external] auditors tasked with doing in relation to fraud when planning and carrying out their audit and what should they do in the way of internal or external reporting if or when actual or potential instances of fraud (e.g. bribery) materialize.

It is clear that whilst there may be an expectation or misconception as to what the external auditor should be doing in these circumstances, the realities are somewhat different and determined by the technical framework in which an external auditor operates. The external auditors primary purpose is audit the financial statements of a company with the expressed purpose of forming and expressing an opinion as to whether they give a true and fair view and are free from **material misstatement.** (BDO Emphasis). This impacts not only on what external auditors should be expected to do in relation to detecting foreign bribery but also on what it should do if/when he detects possible bribery situations including any reporting obligations. The concept of materiality is intrinsic to auditing and therefore to audit in its absence would be tantamount to having to verify each and every transaction of a company which is clearly neither feasible nor desirable for the purposes of expressing an opinion on the financial statements. ISA 320[6] offers a definition of materiality viz.

"Information is material if its omission or misstatement could influence the economic decisions of users……Materiality depends on the size of the item or the error judged in the particular circumstances of its omission or misstatement…."

It is clear to us from the commentary to the Convention[7] that the concept of materiality is already recognized by the Working Party in its comments on "small "facilitation" payments. Moreover, it is our view that only the same standard of materiality used by the auditor to plan and carry out the audit could be used to assess if a transaction warrants reporting due to connection with possible bribery. Nonetheless the judgement factor implicit in auditing and the fact that the "circumstances" impact on the assessment, offer the possibility that transactions that are otherwise below a materiality threshold, may be so judged based on the "particular circumstances".

Furthermore an external audit is not planned or carried out with a view to ensuring that all acts of bribery are uncovered nor is an assurance being given that there are no such acts of bribery that remain undetected. Only a forensic audit specifically designed with [foreign] bribery detection in mind, could hope to achieve such objectives. Such exercises are invariably costly, lengthy and quite different in nature to statutory audits carried out by external auditors.

Expanding the spectrum of companies subject to external audit

Given the foregoing, there is no certainty that extending the application of the requirement to have a statutory external audit (e.g. to private companies in some jurisdictions, to unlisted entities in some

[4] The Auditor's Responsibility to Consider Fraud in an Audit of financial statements

[5] Consideration of laws and regulations in an audit of financial statements

[6] Audit Materiality

[7] Commentary paragraph 9 re Article 1 of the Convention

jurisdictions or to "small" companies as defined, in some jurisdictions) would necessarily increase levels of bribery prevention or detection. It would be a matter for regulators or public policy bodies to determine whether the benefits of compelling external audits in all such situations would justify the additional costs and burdens arising, particularly on what are known as small and medium sized companies (SMEs) in some countries. As part of such debate, we would propose that there may be other more effective mechanisms that could be introduced for companies currently outside the scope of external audits. These would include imposition of the same rules as regards books and records, internal controls and other corporate governance requirements as apply to companies currently externally audited in such countries.

We note and agree with the OECD observations that in some territories, SMEs or unlisted entities (who may be quite large by any measurement criteria), represent the majority of corporate activity and are as exposed to all aspects of the [foreign] bribery possibility as large/listed entities. We would advocate proportionate but effective enhancement of corporate governance requirements for such entities with the need for a compulsory external audit to be considered by public policymakers and relevant stakeholders.

Adequate obligation on external auditors for reporting actual or potential bribery to the competent authorities

As regards whether there is "an adequate obligation for reporting to the competent authorities" on the independent external auditors, auditors apply the guidance contained in ISA 250 unless overridden by local legal requirements. This can be the only basis on which external auditors report on suspected fraud (e.g. bribery) due;

a) to the primary governance and reporting obligations resting with management,

b) the duty of confidentiality which an auditor will have

c) the difficulty for an auditor in forming a view that a situation constitutes possible [foreign] bribery as this can only be determined by the process of law and requires skills in which auditors are not typically trained

As the Consultation Paper itself acknowledges, in many countries, reporting by external auditors to outside authorities is prohibited or excluded in practice due to the application of confidentiality requirements. (Para 108). We are disappointed therefore to see somewhat negative references to the "reluctance of external auditors to be turned into whistleblowers" in Para 110 and the allusion "that auditors might have an incentive to maintain less complete records…." (also Para 110). External auditors' internal and external reporting obligations are determined by the mix of local law and professional guidance pertaining to the area and are not influenced by a "general reluctance to report to the competent authorities…". We feel that the profession's position in this regard is unfairly presented in the Consultation Paper and will be deserving of closer scrutiny by the Working Party.

Adequate standard for triggering a report of foreign bribery either internally or externally to the competent authorities

Regarding whether the standard is adequate for triggering a report of foreign bribery either internally or externally, ISA 250 sets out the standard to which an external auditor should operate when reporting. In relation to internal reporting, the auditor is not required to report internally to the company potential violations which would be clearly "inconsequential or trivial". In variably this would be a much lower level of materiality than that which would be used by the auditor in planning and carrying out the external audit and in forming an opinion on the financial statements etc. The latter materiality threshold can be the only basis for reporting externally unless national law dictates otherwise to ensure that client confidentiality is not needlessly breached and auditors reporting in good faith are not subject to litigation

by parties subsequently found to be innocent of any wrongdoing by the authorities. Given that this threshold was the basis of the work done by the external auditor, it is logical also that it would be the basis of external reporting by an auditor.

The US legal concept of "safe harbor" may offer a progressive solution towards facilitating greater levels of external reporting by auditors acting in good faith but the materiality threshold for such reporting logically will remain that which applies to the planning and carrying of the audit etc.

Notwithstanding any such reporting, we would contend that the primary obligation to prevent and detect fraud (including foreign bribery) remains with the management of the company. The primary role of the external auditor will continue to attach to issuing an opinion on the financial statements and not to making assessments or reporting of possible instances of bribery.

Role of internal auditor

In the opinion of BDO International, the internal audit function (where it exists) should form part of the core corporate governance structures of a company and is inherently well placed to prevent and detect foreign bribery by dint *inter alia* of its "ability to positively influence management's and the board's willingness to combat foreign bribery due to the integral relationship between the internal audit function and those responsible for management and oversight of internal controls"[8]. This is a viewpoint contained in the Consultation Paper which we would endorse. A typical suite of internal audit tools would include basic anti-bribery oriented activities such as monitoring operational information and contracts/transactions, examining financial and non-financial information in relation to company activities etc.

To our knowledge the internal audit profession is not as large or well structured as that of external auditors but it is clear that it should be be a key element of any efforts to combat [foreign] bribery. We note the reference in the Consultation to the *Institute of Internal Auditors* and its "Practice Advisory" on the "Auditor's Responsibilities relating to Fraud Risk Assessment, Prevention and Detection" which states that the internal auditor should have sufficient knowledge to identify the indicators of fraud. The Consultation indicates the definition of fraud used by the IIA and which is likely to be taken to include bribery.

Role of internal company controls

We would also endorse the four recommendations regarding internal company controls as first contained in the 1997 Recommendation and repeated in the Consultation Part 3, Section 4.1 sub-section 97, as being examples of internal control activity which all companies should adopt, particularly those engaged in transnational activity.

Steps that should be taken to address any of the specific issues raised in the Consultation Paper

We would concur with the OECD observation that greater awareness of the issue of foreign bribery would increases the likelihood of better incidence of prevention and detection. How to achieve such heightened awareness will be a "cross cutting" challenge given the circumstances. In common with all variations of fraud, it is unlikely that such behavior will ever be fully eliminated but greater awareness is pre-requisite to addressing the issues.

We would endorse any recommendation for increased and more adequate *whistleblower* protections for anyone who might be in a position to bring possible [foreign] bribery situations to the attention of the competent authorities. This might include company personnel, company management, public officials or

---

[8] Consultation Paper, Part 3, section 4.1 clause 104

others. In this regard, we reiterate our suggestion above for "safe harbor" type mechanisms to protect external auditors making external or internal reports in relation to possible bribery when such reports are made in good faith and within the regulatory and auditing structures applying. In our opinion, this will require changes to national law in OECD Parties and possibly also in relation to elements of professional guidance in the areas of confidentiality, reporting and possibly others.

In common with other global audit networks, BDO International supports the work of the World Economic Forum in the area of anti-corruption initiatives and Transparency International in seeking to develop tools in the area of anti-bribery. We commend the OECD Working Party on its efforts over the last ten years and hope to be able to support and comment on further practical and reasonable initiatives in this regard once the Working Party concludes its review of the instruments currently in place.

We would be available to clarify and elaborate upon any aspects of this comment letter which would interest the Working Party.

.