September 2015

IESBA MAY 2015 EXPOSURE DRAFT: RESPONDING TO NON-COMPLIANCE WITH LAWS AND REGULATIONS
Comments from the Anti-Corruption Division of the OECD

I. Background: The Anti-Corruption Division and the OECD Anti-Bribery Convention

The Anti-Corruption Division of the OECD (ACD) has followed with interest the IESBA's discussions on amending the IESBA Code of Ethics for Professional Accountants (the Code) with respect to responses to non-compliance with laws and regulations (NOCLAR) by a professional accountant (PA).

ACD's interest in this work stems from the Division's role as Secretariat to the OECD Working Group on Bribery (WGB). The WGB brings together the 41 countries party to the OECD Anti-Bribery Convention (the Convention). The Convention requires parties to criminalise and enforce bribing of foreign public officials in international business transactions. The WGB evaluates parties' compliance with these requirements. In June 2015 it completed the third round of evaluations.

The Convention recognises the important role accounting and auditing plays in efforts to prevent and detect suspected cases of foreign bribery. Article 8 of the Convention requires Parties to have adequate books and records provisions in place to prohibit false accounting practices for the purpose of foreign bribery or hiding such bribery.

In 2009 the OECD issued a Recommendation for Further Combating Bribery. This Recommendation imposes additional obligations on WGB parties to further combat foreign bribery. These new obligations include Recommendation X, which requires countries to strengthen their accounting and auditing frameworks and to encourage companies in their jurisdictions to adopt adequate internal controls, ethics and compliance programmes.

Of particular relevance is Recommendation X.B which relates to external auditors. Under Recommendation X.B countries must, *inter alia*:

- require an external auditor who discovers suspected foreign bribery to "report this discovery to management and, as appropriate, to corporate monitoring bodies";
- encourage companies to "actively and effectively respond" to reports of foreign bribery received by an external auditors; and
- consider requiring external auditors to report suspected foreign bribery to "competent authorities" (e.g. law enforcement or regulatory authorities) and ensure auditors who make such reports "reasonably and in good faith" are protected from legal action.

Over the course of the WGB's third evaluation round (conducted between October 2010 and June 2015), the WGB recommended that 30 of the 38 member countries which have been through a Phase 3 review take steps to strengthen their compliance with Recommendation X.B.[1]

Also relevant is Recommendation X.C, which requires member countries to "encourage companies to develop and adopt adequate internal controls, ethics and compliance programmes or measures for the purpose of preventing and detecting foreign bribery" and put in place reporting channels for internal whistleblowers (which would include internal auditors).

[1] These countries were Argentina, Australia, Austria, Belgium, Brazil, Chile, Czech Republic, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Mexico, New Zealand, Norway, Poland, Portugal, Slovak Republic, Slovenia, South Africa, Spain, Sweden, and Switzerland.

The ACD hopes that the IESBA's amendments to the Code of Ethics might encourage countries to reconsider or make changes to their legislation regarding PA's NOCLAR reporting obligations, thereby bringing more countries into full compliance with Recommendation X.

II. ACD Remarks on the Exposure Draft

a. The importance of reporting NOCLAR: Sections 225.1-4 and 360.1-4

The WGB's work has consistently highlighted the importance of both internal and external auditors in detecting and preventing bribery and corruption. The OECD's Foreign Bribery Report found that of the 427 concluded cases of foreign bribery between 1999 and 2014, one third were brought to the attention of law enforcement by the company self-reporting.[2] Of the companies who chose to self-report, 31% became aware of the foreign bribery through an internal audit.[3]

Despite this figure, the overall number of cases detected by PAs, especially external auditors, remains low. This suggests that this form of detection is under-utilised. For this reason, the ACD fully supports the objectives contained in proposed Sections 225 and 360 which emphasise that both internal and external auditors should not turn a blind eye to NOCLAR, and should ensure that such issues are reported to management, those charged with governance, or, where appropriate, relevant authorities.

b. The definition of NOCLAR: Sections 225.6 and 360.6

In the course of the WGB's evaluations, it has become apparent to the ACD that PAs remain uncertain whether suspected foreign bribery could constitute NOCLAR. For this reason the ACD is encouraged to see "corruption and bribery" listed in proposed Sections 225.6 and 360.6 as a specific example of the laws and regulations which may lead to NOCLAR.

c. Limits on reporting NOCLAR: Sections 225.29 and 360.28, 360.11, and 225.27 and 360.26

When asked about reporting NOCLAR to external authorities, external auditors with whom the ACD meets in the context of the WGB's evaluations have cited the duty of confidentiality as a barrier to making such reports. The ACD is therefore supportive of proposed Sections 225.29 and 360.28 which will clarify that reporting to appropriate authorities in the circumstances prescribed in the Code will not constitute a breach of the PA's duty of confidentiality.

However, the ACD recognises that there may be additional constraints on reporting NOCLAR. While external auditors may be deterred primarily by the duty of confidentiality and corresponding threat of legal action, internal auditors face different issues. As employees, internal auditors who report outside the company may be faced with discriminatory or disciplinary action. In this context, the ACD supports the inclusion of proposed Section 360.11 which encourages internal auditors to use company procedures such as anonymous reporting channels, if available. They also note the inclusion of proposed Sections 225.27 and 360.26 which encourage PAs to have regard to the existence of whistleblower protection prior to disclosing NOCLAR outside the company to an appropriate authority.

d. The "substantial harm" and "third party" tests: Sections 225.21-27 and 360.20-26

Under proposed Sections 225.21 and 360.20, a PA may decide to take further action (beyond reporting NOCLAR to management or those charged with government) if there is "credible evidence of actual or potential substantial harm to the interests of the entity, investors, creditors, employees or the wider public". In making this decision, the PA is required to consider whether a "reasonable and informed third party" would conclude that the PA is acting appropriately "in the public interest" (proposed Sections 225.25 and 360.24). Proposed Sections 225.27 and 360.26

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2 OECD (2014), *Foreign Bribery Report: An Analysis of Crime of Bribery of Foreign Public Officials*, pg. 15-16.

3 Ibid, pg. 16-17.

go on to state that when the PA is deciding whether to disclose NOCLAR to an appropriate authority the PA should consider "the nature and extent of the actual or potential harm from the matter to the wider public, including the investing public, creditors or employees".

The ACD is concerned that these provisions are overly lengthy and complicated, with overlapping tests and considerations. The lack of a clear, certain test will discourage reporting, as PAs are likely to err on the side of caution for fear of potential litigation. As currently drafted, proposed Sections 225.20-23 and 360.19-22 appear restrictive. PAs are likely to take a narrow reading of these provisions and take further action only if *all* factors are present. This could prevent the reporting of serious NOCLAR. For example, a PA may come across evidence of a multi-million dollar bribery scheme which occurred in relation to a division of the company which is no longer operating. In this case, the PA may conclude that there is limited risk that the bribery will reoccur. On a narrow reading of proposed Section 225.21, the PA could infer that even though management has failed to take appropriate action and the potential for criminal charges creates a serious risk of harm to investors, further action is unnecessary due to the low risk of recurrence. The ACD would submit that failure to report in this instance would not be in the public interest and would be contrary to the stated intention of proposed Sections 225 and 360. Consequently, the ACD would submit that proposed Section 225.21 should include a clearer test, which offers straightforward and unambiguous guidance to PAs on the specific situations in which further action will be necessary (e.g. where there is credible evidence of a criminal offence or substantial harm alongside a failure to act by management). The test should make clear which factors are determinative and which are for consideration only.

In addition to a clear test, the "third party" test may assist PAs to objectively assess their decision and may therefore be beneficial. However, the ACD would submit that the additional test and factors in proposed Sections 225.27 and 360.26 over-complicate the issue and should be removed in favour of one clear test to replace proposed Sections 225.21-23 and 360.20-22. Removal of the factors in proposed Sections 225.27 and 360.26 is also necessary because these factors are likely insufficient to require the reporting of corruption except in very specific cases. The examples listed in proposed Sections 225.27 and 360.26 are extreme and would not necessarily be triggered by an act of corruption, even of a significant nature (e.g. the massive Siemens corruption case, which involved the payment of USD 1.4 billion in bribes to foreign public officials, would likely not meet the stated criteria). Consequently, the ACD considers that the criteria listed in Section 225.27 are too extreme and should be removed in favour of one clear, stand-alone test to replace proposed Sections 225.21-23 and 360.20-22.

e. The duty or the right to report suspected NOCLAR: Sections 225.24-25 and 360.23-24

The ACD notes that the May 2015 Exposure Draft deviates from previous versions regarding PAs NOCLAR reporting obligations. Under the proposed amendments to the Code, if a PA suspects NOCLAR and management does not take appropriate steps to address the matter, PAs *may* report an instance of suspected NOCLAR to regulatory or law enforcement authorities where this is deemed necessary (proposed Sections 225.24-225.25 and 360.23-360.24). Previous proposals included a *requirement* that PAs report suspected NOCLAR to regulatory or law enforcement authorities.

The ACD has taken note of the IESBA's reasoning for this change (Exposure Draft, para. 60), including the lack of protections available in certain jurisdictions for PAs who report. The ACD is well-aware that protections for those who report bribery are often inadequate; this is an area of continued focus for the WGB. Nonetheless, the ACD does not feel that the reasoning presents a complete barrier to including an *obligation* for PAs to report NOCLAR in specific circumstances. As set out in the Exposure Draft, PAs must go through a series of steps before deciding to take further action, including "whether there exists robust and credible protection from civil, criminal or professional liability or retaliation" (proposed Sections 225.27 and 360.26). If the IESBA's primary concern with an obligation to report is a lack of protections for PAs, the ACD suggests that proposed Sections 225.27 and 360.26 could be extended to exempt PAs from reporting where they have a justifiable concern about potential disciplinary or discriminatory action or liability.

A lack of discretion regarding reporting may also offer some level of protection to the PA; if the PA has no option but to report then interested parties have nothing to gain in threatening reprisals or taking retributive action. In contrast, giving the PA the option of keeping quiet may unintentionally create an incentive for threats or retribution.

An obligation to report would also ensure consistency with current money laundering regulations in most countries, which require PAs to report suspicions of money laundering to law enforcement.

In ACD's experience, countries are often reluctant to take action regarding PA's NOCLAR reporting obligations due to reluctance to go beyond the international accounting and auditing standards set by IFAC. The ISA standards are cited as a reason why governments do not go so far as to require PAs to report suspected NOCLAR to law enforcement. Some jurisdictions (e.g. Japan) have a legal requirement that external auditors report foreign bribery to law enforcement. While such a requirement goes beyond the requirements of Recommendation X.B, it has been recognised by the WGB as an example of good practice. The ACD hopes the proposed changes to the Code contained in the Exposure Draft might encourage more countries to follow this good practice. However, it is likely that as long as the Code *allows* rather than *obliges* PAs to report NOCLAR to law enforcement or regulatory authorities, countries will remain reluctant to legislate beyond this.

f. Reporting to an appropriate authority, withdrawing from the engagement or informing the parent entity: Sections 22.24 and 360.23

Pursuant to the May 2015 Exposure Draft, where a PA suspects NOCLAR and management does not take appropriate steps to address the matter, the PA may need to take further action (proposed Sections 225.20 and 360.19). Under proposed Section 225.24 further action may include reporting the matter to an "appropriate authority" or "withdrawing from the engagement". Proposed Section 360.23 also lists "informing the parent entity" as a potential further action for PAs in business.

Given the important role PAs play in detecting fraud and corruption, the ACD considers that the Code should not present these actions as alternatives; rather, where justifiable and provided there are no relevant constraints (e.g. a lack of whistleblower protection for internal auditors), PAs should *always* report to law enforcement, regardless of whether they also choose to resign from the engagement and/or inform the parent entity. Mandating such reporting is the only way to guarantee full use is made of PAs' vital role in detecting corruption.

III. Conclusion

As a final point, the ACD notes that the IESBA has undertaken, and is continuing to undertake work to ensure any amendments to the Code are consistent with ISA 250. The ACD notes that ISA 240 is also relevant and trusts that the IESBA will be ensuring any changes to the Code are also reflected in ISA 240.

In summary, the ACD appreciates the opportunity to comment on the IESBA's exposure draft and commends that IESBA for its work thus far. In general, the ACD is supportive of the direction the IESBA is taking, but considers that there remains room for improvement in the Code to fully realise accountant's and auditor's role in preventing and detecting bribery and corruption.

If you have any questions or comments on this submission, please contact Liz Owen, DAF/ACD (Liz.Owen@oecd.org).