

Overall Observations

April 17, 2000

Financial Transparency and Accountability Initiative OECD Convention on Combating Bribery of Foreign Public Officials

Transparency International

This document was prepared by a task force of Transparency International. The objective of the project was to collect and analyze data to assist the OECD Working Group on Bribery in International Business Transactions in the areas of books and records, internal controls and auditing practices. The frame of reference was Article 8: Accounting, of the OECD Convention and Recommendation V.: Accounting Requirements, External Audits, and Internal Company Controls, of the 1997 Revised Recommendation. During the Fall of 1999, the task force documented current practices in 16 countries, including the 11 largest exporters and developed country-specific observations which are included in a separate report entitled, "Country Analysis and Observations." In addition, certain overall observations developed by the task force are included in this document.

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Executive Summary

For 16 countries, the task force reviewed the status of implementation of the requirements and recommendations relating to books and records, internal controls and auditing practices of the OECD *Convention on Combating Bribery of Foreign Public Officials* (the “Convention”) and the related OECD *1997 Revised Recommendation*, and developed certain observations. The Convention requires among other things that bribery of foreign public officials be made an illegal act.

While not specifically reviewed, the task force also considered the OECD recommendations pertaining to financial statement disclosures and requirements for audited financial statements. In addition to country-specific observations, the task force had a number of overall observations that the task force believes will be important to the successful implementation of the Convention.

Books and Records

While most countries have legal requirements for keeping books and records, many countries do not extend these requirements to all companies engaged in international transactions or to affiliates outside of the country, the inclusion of which would make the requirements more effective. Also a number of countries’ requirements are out of date and would benefit from modifications towards legal requirement that meet the guidelines set forth in the section of this report, entitled “Observations Relating to Books and Records.”

In summary, these guidelines include prohibiting the establishment of off-the-books accounts and the making of off-the-books transactions. The guidelines also include requirements that all transactions be fully identified, described adequately and accurately, and properly classified in the accounts. The guidelines should be consistently applied to both domestic and foreign subsidiaries, affiliates and related entities over which the company has significant influence in order to prevent companies from circumventing the books and records requirements of their home countries. Recognizing that such foreign entities are generally not directly subject to the parent country’s laws, the parent country’s laws and regulations should in effect, hold the parent company responsible for the foreign entities books and records to the same extent as the parent company’s domestic books and records.

Internal Controls

Most countries do not have an explicit legal requirement that a company must maintain an adequate system of internal controls. An important aspect of an internal control system is the existence of procedures which, if properly designed, will help ensure compliance with applicable laws and regulations. The task force believes that a legal requirement for an adequate system of internal controls is a key foundation for preventing and detecting illegal acts including bribery. However, we do not believe such requirements should be overly prescriptive of how internal controls are to be established, but rather should rely on judgment in light of the comprehensive frameworks that have been developed, as outlined in Appendix B. The task force also believes that such requirements should address overall principles of corporate governance at least to the extent of requiring the inclusion of directors independent of management and the company as members of the corporate governing body, in particular the audit committee.

Certain components of internal control frameworks are particularly effective in the prevention of illegal acts including bribery. Such internal control components are integral to effective corporate governance practices and include the following: setting the “tone at the top” which includes making top management of a company responsible for establishing and maintaining an effective internal control system with appropriate oversight by corporate monitoring bodies; adopting a code of conduct which provides information and guidance to those within a company about the company’s philosophy toward ethical business conduct and the basic principles governing that conduct; and establishing processes to monitor compliance with policies and procedures that are implemented to prevent and/or detect illegal acts including bribery.

Auditing Practices

Auditing standards in relation to illegal acts including bribery include measures to detect material misstatements in financial statements, which could result from illegal acts, and require reporting of known illegal acts including bribery to appropriate corporate governing bodies, such as an audit committee or corporate supervisory board. In addition, auditing standards typically require the auditor to obtain an understanding of the financial reporting internal control system, which may include internal control procedures designed to properly report in financial statements the consequences of compliance and material noncompliance with applicable laws and regulations, and report any detected material weaknesses to the appropriate level within the company. Together with other auditing standards, these procedures help reduce the risk of bribery occurring and not being properly reported in the financial statements.

The task force’s survey revealed that auditing requirements vary from country to country. Accordingly, the task force believes improved quality and greater consistency of audits could be achieved if all countries adopt the International Standards on Auditing (“ISAs”) in their entirety as minimum auditing standards or modify existing standards relevant to illegal acts including bribery to meet or exceed the ISAs. Large global auditing firms have auditing methodologies and policies consistent with the ISAs and are committed to raising country auditing standards and practices to a common high standard based on the ISAs.

The ISAs relating to illegal acts, ISA 250 *Consideration of Laws and Regulations in an Audit of Financial Statements*, and internal controls, ISA 400 *Risk Assessment and Internal Control*, are particularly relevant to the OECD’s efforts to prevent or detect bribery of foreign public officials. The task force believes both of these auditing standards could be enhanced to provide greater recognition of the need for robust corporate governance principles and internal control practices designed specifically to prevent or detect illegal acts including bribery, which are discussed above under “Internal Controls.” Further, such enhancements to these auditing standards could help ensure that management and corporate monitoring bodies are made aware of significant weaknesses or absence of such internal control components as part of the annual audit. Organizations such as the OECD and Transparency International (“TI”) should support such enhancements of the ISAs by the International Auditing Practice Committee.

Requirements for Audited Financial Statements

A legal requirement for audited financial statements can help provide assurance that the various requirements of Article 8 and Recommendation V. for books and records, internal controls and financial statement disclosures are effectively implemented and maintained. Generally each country's requirements are based on a company's size and/or ownership attributes (publicly traded, third party debt, etc.). The task force believes that each country should review its legal requirements for independent audits to determine that companies that have exposure to the bribery of foreign officials (such as those in certain industries or with significant international operations and business activities, etc.) are covered by a legal requirement for an annual audit by independent auditors.

Financial Statement Disclosures

Accounting standards and practices vary from country to country as to the requirements for disclosure of material contingent liabilities which could include liabilities related to material bribes or known bribes which are likely to have a material effect on the company's financial statements. The International Accounting Standards ("IAS") include accounting standards and disclosure requirements for material contingent liabilities. The task force believes improved quality and consistency of accounting and disclosure can be achieved if countries, where accounting standards do not meet or exceed IAS, adopt IAS in their entirety as minimum accounting standards or modify existing standards relevant to disclosure of contingent liabilities to meet or exceed the IAS.

In addition, ISA 250 discussed above under "Auditing Practices," provides the auditor with guidance on evaluating the possible effect on the financial statements of noncompliance with laws and regulations which could include bribery. As stated in ISA 250, "the auditor considers: the potential consequences, such as fines, penalties, damages, threat of expropriate of assets, enforced discontinuation of operations and litigation; whether the potential financial consequences require disclosure; and whether the potential financial consequences are so serious as to call into question the true and fair view (fair presentation) given by the financial statements." Further, ISA 250 states, "if the auditor concludes that the noncompliance has a material effect on the financial statements, and has not been properly reflected in the financial statements, the auditor should express a qualified or an adverse opinion."

With regard to audited financial statements, the task force believes each country should enact a legal requirement that each company engaged in significant international business transactions:

- (1) issue annual financial statements prepared in accordance with generally accepted accounting standards that equal or exceed the requirements of International Accounting Standards;
- (2) engage an independent auditor to conduct an external audit of the annual financial statements who meets or exceeds the independence standards established by the International Federation of Accountants ("IFAC"), as set forth in its Code of Ethics for Professional Accountants; and
- (3) obtain an external audit in accordance with generally accepted auditing standards that equal or exceed the requirements of International Standards on Auditing.

1997 Revised Recommendation with Comments

REVISED OECD RECOMMENDATION ON COMBATING BRIBERY IN INTERNATIONAL BUSINESS TRANSACTIONS - Adopted by the Council on May 23, 1997

The following represents a summary of the 1997 Revised Recommendation relating to accounting requirements, external audit, and internal company controls (the text of the Recommendation is in italics) and comments on what signatory countries have done or should do to implement the recommendations and to achieve the objectives of Article 8. The analysis is based primarily on the task force's observations discussed throughout this document. Various groups including governments and regulators, accounting and auditing professional organizations, and the users of financial statements such as investors and creditors, within the signatory countries need to take part in the process of implementing Article 8.

V. Accounting Requirements, External Audit and Internal Company Controls. *The Council recommends that Member countries take the steps necessary so that laws, rules and practices with respect to accounting requirements, external audit and internal company controls are in line with the following principles and are fully used in order to prevent and detect bribery of foreign public officials in international business.*

<i>Council Recommendation</i>	Comments
A. Adequate Accounting Requirements	
<p>i) <i>Member countries should require companies to maintain adequate records of the sums of money received and expended by the company, identifying the matters in respect of which the receipt and expenditure takes place. Companies should be prohibited from making off-the-books transactions or keeping off-the-books accounts.</i></p>	<p>The task force noted that a number of countries' books and records requirements are out of date, do not include certain key provisions, and would benefit from modifications towards legal requirements that meet the guidelines summarized by the task force. Specific provisions omitted from some countries' books and records requirements include not extending the requirements to all companies engaged in significant international business transactions and to affiliates outside of the country over which the company has significant influence, the inclusion of which would make the requirements more effective. In addition, some countries' requirements do not include provisions that explicitly prohibit the establishment of off-the-books accounts and the making of off-the-books transactions.</p>
<p>ii) <i>Member countries should require companies to disclose in their financial statements the full range of material contingent liabilities.</i></p>	<p>Accounting standards and practices vary from country to country as to the requirements for disclosure of material contingent liabilities which could include liabilities related to material bribes or known bribes which are likely to have a material effect on the company's financial statements. The IAS include accounting standards and disclosure requirements for material contingent liabilities. The task force believes improved quality and consistency of accounting and disclosure can be achieved if countries, where accounting standards do not meet or exceed IAS, adopt IAS in their entirety as minimum accounting standards or modify existing standards relevant to disclosure of contingent liabilities to meet or exceed the IAS.</p>

<p>iii) <i>Member countries should adequately sanction accounting omissions, falsifications and fraud.</i></p>	<p>The project did not include a review of sanctions, however the task force agrees that countries should have adequate sanctions. In recognition of the fact that an adequate system of internal controls can be effective for preventing, detecting and reporting criminal conduct, and as an incentive for companies to maintain a system of internal controls, a jurisdiction should adopt sentencing guidelines that provide for more lenient penalties if a company has in place an effective system of internal controls.</p>
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Council Recommendation	Comments
<p>B. Independent External Audit</p>	
<p>i) <i>Member countries should consider whether requirements to submit to external audit are adequate.</i></p>	<p>A legal requirement for audited financial statements can help provide assurance that the various requirements of Article 8 and Recommendation V. for books and records, internal controls and financial statement disclosures are effectively implemented and maintained. The requirement for audited financial statements by the country should be at a level that covers companies that have risk profiles with regard to bribery of foreign public officials. Companies having such a profile might include those that (1) have significant international operations and business activities, (2) conduct business in industries where bribing foreign public officials has been known to occur in the past, (3) are above a minimum size, or (4) have publicly traded securities or receive financing from third parties.</p>
<p>ii) <i>Member countries and professional associations should maintain adequate standards to ensure the independence of external auditors which permits them to provide an objective assessment of company accounts, financial statements and internal controls.</i></p>	<p>The project did not include a review of the adequacy of independence standards for external auditors in the selected countries. As noted in the article included as Appendix F, the major accounting firms have proposed to enforce globally within their own firms a code of conduct on independence issues based on IFAC's Code of Ethics for Professional Accountants. In addition, the IFAC Ethics Committee hosted a forum in Rome in November 1999 to focus on independence issues and to strengthen its rules of independence. As a result and as noted in Appendix E, IFAC will issue an exposure draft focusing on auditor independence in 2000.</p> <p>The task force believes that IFAC's model should be used by each country as a minimum standard to establish external auditors independence standards.</p>

<p>iii) <i>Member countries should require the auditor who discovers indications of a possible illegal act of bribery to report this discovery to management and, as appropriate, to corporate monitoring bodies.</i></p>	<p>Auditing requirements vary from country to country. The ISAs require auditors to consider laws and regulations in an audit of financial statements, and to communicate their findings to management and others charged with corporate governance. Improved quality and greater consistency of audits could be achieved if all countries adopt the International Standards on Auditing (ISAs) in their entirety as minimum auditing standards or modify existing standards relevant to illegal acts including bribery to meet or exceed the ISAs. Large global auditing firms have auditing methodologies and policies consistent with the ISAs and are committed to raising country auditing standards and practices to a common high standard based on the ISAs.</p>
<p>iv) <i>Member countries should consider requiring the auditor to report indications of a possible illegal act of bribery to competent authorities.</i></p>	<p>This is a complex area to address since auditors are generally bound by confidentiality requirements that preclude the auditors from reporting client matters to third parties. In addition, explicitly requiring auditors to report a possible illegal act could interfere with the auditors ability to obtain free access to information from the company.</p> <p>Perhaps one way of implementing this recommendation could be to require the auditor to report to competent authorities in the event that management and/or corporate monitoring bodies did not take appropriate action related to an illegal act that the auditor previously reported to management and/or corporate monitoring bodies.</p>

Council Recommendation	Comments
C. Internal Company Controls	
<p>i) <i>Member countries should encourage the development and adoption of adequate internal company controls, including standards of conduct.</i></p>	<p>Most countries do not have a legal requirement that a company must maintain an adequate system of internal controls. An important aspect of an internal control system is the existence of procedures which, if properly designed, will help ensure compliance with applicable laws and regulations. While the task force believes that legal requirements for an adequate system of internal control is a key foundation for preventing and detecting bribery, we do not believe such requirements should be overly prescriptive but rather should rely on judgment in light of the comprehensive frameworks that have been developed as outlined in Appendix B. The task force also believes that such requirements should address overall principles of corporate governance at least to the extent of requiring the inclusion of directors independent of</p>

	<p>management and the company as members of the governing body.</p> <p>Certain components of internal control frameworks are particularly effective in the prevention of illegal acts including bribery. Such internal control components are integral to effective corporate governance practices and include the following: setting the “tone at the top” which includes making top management of an organization responsible for establishing and maintaining an effective internal control system with appropriate oversight by corporate monitoring bodies (as stated in the <i>OECD Principles of Corporate Governance</i>, “The board should fulfill certain key functions, including ensuring the integrity of the corporation’s accounting and financial reporting systems, including the independent audit and that appropriate systems of control are in place, in particular, systems for monitoring risk, financial control, and compliance with the law.”); adopting a code of conduct which provides information and guidance to those within an organization about the organization’s philosophy toward ethical business conduct and the basic principles governing that conduct; and establishing processes to monitor compliance with policies and procedures that are implemented to prevent and/or detect illegal acts including bribery.</p>
<p><i>ii) Member countries should encourage company management to make statements in their annual reports about their internal control mechanisms, including those which contribute to preventing bribery.</i></p>	<p>Management reporting about internal control is a key element that is included in several of the existing comprehensive frameworks included in Appendix B. Such reporting can help keep management and others in the company focused on the importance of such control procedures. In addition, such reporting will keep those to whom the company is accountable informed about its internal control activities.</p>

<p>iii) <i>Member countries should encourage the creation of monitoring bodies, independent of management, such as audit committees of boards of directors or of supervisory boards.</i></p>	<p>The creation of corporate monitoring bodies, independent of management and the company, is a fundamental component of good corporate governance practices. As stated in the <i>OECD Principles of Corporate Governance</i>, “The board should be able to exercise objective judgment on corporate affairs independent, in particular, from management. Boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgment to tasks where there is a potential conflict of interest. Examples of such key responsibilities are financial reporting, nomination and executive and board remuneration.” In addition, the auditing standards (ISAs) discussed above are based in part on auditors communicating certain matters to those charged with corporate governance including noncompliance with laws and regulation, material weaknesses in internal control and questions regarding management integrity.</p> <p>Accordingly, the various provisions of the Convention are more likely to be successfully implemented in those countries that require companies to follow good corporate governance practices.</p>
<p>iv) <i>Member countries should encourage companies to provide channels for communication by, and protection for, persons not willing to violate professional standards or ethics under instructions or pressure from hierarchical superiors.</i></p>	<p>Providing appropriate channels for communication is a key component of internal control that is particularly effective in the identification of illegal acts including bribery and is an integral part of good corporate governance practices. See the comments under C.i) above for a more comprehensive list of such internal control components.</p>

Introduction

Legislators of signatory countries either have ratified or are in the process of ratifying the Convention. Ratification should lead to passage of laws and regulations to give effect to the Convention. While enactment of legislation is a necessary first step, effective enforcement of enacted legislation is also critical to controlling bribery.

Article 8 of the Convention recognizes that the success of the Convention will also depend in part on the adoption of rigorous requirements for books and records, financial statement disclosures, and accounting and auditing standards. TI initiated a project with the principal objective of collecting and analyzing data to assist the OECD Working Group on Bribery in International Business Transactions (“OECD Working Group”) in the areas of books and records, internal controls, and accounting and auditing practices.

A task force consisting of representatives from major international accounting firms and global corporations was formed to collect and analyze data on current practices relative to Article 8 of the Convention and Recommendation V. in 16 countries¹. The results for each country are included in a separate document. From the country specific project, the task force also developed general observations and summarized other information pertaining to the implementation of Article 8 and Recommendation V. These general observations and other information, which are set forth in this document, are intended to be used by the OECD Working Group.

The observations of the task force and other information included in this report provide practical and realistic measures that have been and can be taken to implement Article 8 and Recommendation V. and to improve financial transparency and accountability within each country. While appropriate books and records requirements can contribute to the fight against bribery, those requirements are focused on the detection of bribes that have already occurred as opposed to the prevention of bribes. An appropriate system of internal controls, coupled with responsible corporate governance measures, has proven effective in reducing the incidents of bribery of foreign officials.

Nonetheless, appropriate books and records requirements can contribute to the fight against bribery. As stated in *Fighting Bribery, A Corporate Practices Manual*, 1999, published by the International Chamber of Commerce:

Summary of the ICC Recommendations on Accounting, Auditing and Financial Controls

The provisions on auditing and accurate recordkeeping are among the most important sections of the ICC Rules and the OECD Convention. These provisions deal, not only with putting proper financial controls in place, but also with what to do when the controls fail. The results of bribery can remain masked indefinitely if proper supervision of financial transactions is not implemented at the company level. A failure to account for illegal practices, such as bribery, can have grave consequences for a company and its auditors.

¹ The countries included Belgium, Brazil, Canada, France, Germany, Hungary, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, South Africa, Turkey, United Kingdom and United States.

The provisions of the Convention that deal with books and records requirements, internal controls, financial statement disclosures, and auditing practices are more likely to be successfully implemented in organizations that follow good corporate governance practices. Good corporate governance practices help ensure that an organization's objectives are properly established, executed, and monitored. This point as well as other benefits of a good corporate governance framework is discussed in the *OECD Principles of Corporate Governance*.

Good corporate governance practices include setting the tone at the top of the organization that paying bribes is neither permitted nor tolerated. Organizations should adopt a corporate code of conduct that requires those within the organization to adhere to the organization's beliefs. Companies should also implement internal controls that are designed to be particularly effective in the prevention of illegal acts, and monitor compliance with the corporate code of conduct and other organizational objectives.

In summary, simply stated, while adequate books and records, internal controls and auditing practices are important, preventing bribes in the first place should be the most desirable goal of an organization in the fight against bribery.

Observations Relating to Books and Records

Overview

Many countries will find it necessary to modify their laws in order to comply with Article 8 of the Convention. While the level of modification will vary from country to country, the following guidelines have been developed for consideration when drafting or reviewing such laws.

Some countries have very specific requirements for books and records, while others have more goal oriented requirements. These guidelines are not intended to supplant country-specific measures which lawmakers consider appropriate in the circumstances. The guidelines address areas that historically have allowed bribery and corruption to occur without being discouraged or detected.

Guidelines

- All assets, liabilities, and capital of an organization shall be appropriately recorded in the books and records (i.e., no off-the-books accounts).
- All transactions of a company shall be appropriately recorded in the books and records accurately and in a timely manner (i.e., no off-the-books transactions).
- All transactions must be fully identified, described adequately and accurately, and properly classified in the accounts.
- Transactions that have not taken place shall not be recorded in the books and records (e.g., the recording of non-existent expenditures).
- False documents shall not be used.
- The design of the books and records must include an adequate audit trail (i.e., must be able to provide sufficient supporting evidence in connection with a formal examination or verification of the books and records).
- The requirements for books and records are to be consistently applied to all subsidiaries, affiliates and related entities including foreign entities over which the company has significant influence regardless of their location.
- The country shall provide criminal, administrative and/or civil penalties for omissions and falsifications in respect of the books, records, accounts and financial statements of companies, as required by the second paragraph of Article 8.

Observation

The task force noted that a number of countries' books and records requirements are out of date, do not include certain key provisions, and would benefit from modifications towards legal requirements that meet the guidelines set forth above. Specific provisions omitted from countries' books and records requirements include not extending the requirements to all companies engaged in significant international business transactions and to affiliates outside of the country over which the company has significant

influence, the inclusion of which would make the requirements more effective. Recognizing that such foreign affiliates are generally not directly subject to the parent country's laws, the parent country's laws and regulations should in effect, hold the parent company responsible for the foreign affiliates' books and records to the same extent as the parent company's domestic books and records.

In addition, some countries' requirements do not include provisions that explicitly prohibit the establishment of off-the-books accounts and the making of off-the-books transactions.

Observations Relating to Internal Controls

Introduction

The Council recommended that Member countries take the necessary steps to encourage the development and adoption of adequate internal company controls. In its Revised Recommendation adopted on May 23, 1997, the Council included the following specific principles for internal company controls:

- i) Member countries should encourage the development and adoption of adequate internal company controls, including standards of conduct.
- ii) Member countries should encourage company management to make statements in their annual reports about their internal control mechanisms, including those which contribute to preventing bribery.
- iii) Member countries should encourage the creation of monitoring bodies, independent of management, such as audit committees of boards of directors or of supervisory boards.
- iv) Member countries should encourage companies to provide channels for communication by, and protection for, persons not willing to violate professional standards or ethics under instructions or pressure from hierarchical superiors.

Implementation of such controls is important to the overall effectiveness of the fight against bribery in international business transactions.

Key Components

An internal control system is built on a foundation of practices and procedures that promote compliance with applicable laws and regulations, and timely and accurate financial reporting. An effective internal control system is a basic standard for both the operational and financial integrity of results and is dependent on the existence of a good corporate governance regime. Certain components of an internal control system are particularly effective in the prevention of illegal acts including bribery of foreign public officials.

In recognition of the fact that adequate internal controls are effective for preventing, detecting and reporting illegal acts, and as an incentive for companies to maintain a system of internal controls, a jurisdiction should adopt sentencing guidelines that provide for more lenient penalties if a company has in place an effective system of internal controls. For example, in the United States, where federal sentencing guidelines require an organization convicted of criminal conduct to pay a fine, the existence and effective operation of a program to prevent and detect violations of law is a mitigating factor considered by the sentencing court in decreasing the fine from presumptively high levels.

Integral components of good corporate governance and an internal control system to prevent illegal acts including bribery include the following:

- *Control Environment or “Tone at the Top”*, which means the overall attitude, awareness and actions of directors and management regarding the internal control system and importance in the entity. This includes making top management of a company responsible for establishing and maintaining an effective internal control system with appropriate oversight by a company’s board and board committees that include directors independent of management and the company.

An effective way of transmitting the message about ethical behavior throughout the company is by example. In many companies, people often imitate their leaders. Employees are likely to develop the same attitudes about right and wrong—and about internal control—as those shown by top management. Knowing that the CEO has “done the right thing” ethically when faced with a tough business decision sends a strong message to all levels of the company.

However, setting a good example is not enough. Top management should communicate the entity’s values and behavioral standards to employees. A formal code of corporate conduct is a widely used method of expressing the company’s expectations about duty and integrity.

- *Code of Conduct*, which provides information and guidance to employees and directors in understanding a company’s philosophy toward business conduct and the basic principles and standards governing that conduct, is essential. Elements of a business conduct policy that are especially important in the prevention of bribery of foreign public officials include requirements that prohibit employees and representatives of a company from inappropriate activities such as payment of bribes, illegal political contributions, or other illicit payments.
- *Conflicts of Interest* must be avoided to ensure that an employee’s (and other representatives of a company) interests do not conflict with the interests of the company. Conflicts of interest can divide an individual’s loyalty to the company and result in inappropriate actions. For example, payments or any form of compensation from suppliers, customers, competitors or others seeking to do business with the company may constitute an improper conflict of interest.
- *Monitoring of internal control processes* is an important component of an internal control system. An effective internal control must be monitored and evaluated on a continual basis, as operating conditions change (both internally and externally). Establishing processes to monitor compliance

with policies and procedures that are particularly relevant to illegal acts is essential to the effectiveness of an internal control system and the fight against illegal acts. Such processes include confirmation by personnel of compliance with codes of conduct and other policies that are particularly relevant to illegal acts, internal audit reviews or other management reviews.

For example, the existence of a written code of conduct, and an employee acknowledgment process, does not ensure that it is being followed. Further, as mentioned above under “Tone at the Top”, compliance with ethical standards, whether or not embodied in a written code of conduct, is best ensured by top management’s actions and examples. Of particular importance are the penalties to employees who violate such codes, mechanisms that exist to encourage employees to report violations, and disciplinary actions against employees who fail to report violations. Messages sent by management’s actions in these situations quickly become embodied in the corporate culture.

- *Reporting of management’s assessment* of the effectiveness of the internal control system can help management and others in the company to focus on the importance of internal controls. In addition, those to whom the company is accountable will be kept informed by such internal control reporting.
- *Assignment of responsibility* to specific individuals for the various components of internal control is an essential element of an effective internal control system.

Many of the above components of an internal control system are included in frameworks that have been developed in several countries and referenced in related professional literature and corporate governance materials. These sources define internal control and provide additional guidance for companies on how to implement an internal control system. Included in Appendix B is additional information on these existing sources.

Regardless of the materials that a company might reference in developing or enhancing an internal control system, the internal controls will need to be adapted by the company in the context of many factors. These factors include the economic, political, legal and social environment of the country or countries in which an company operates as well as the company’s size and other characteristics.

The success of developing and adopting these internal controls over bribery will depend on efforts to strengthen corporate governance practices. Likewise, enhancing the auditing standards to be more explicit about considering internal control elements that are particularly relevant to the prevention of illegal acts and reporting deficiencies will also contribute to the success of countries’ implementation of such internal controls.

A key principle of corporate governance that is essential to the functioning of the internal controls over illegal acts as set forth above, is appropriate oversight by a corporate monitoring body that includes members independent of management and the company. This point is addressed in the OECD ad hoc task force on corporate governance report, *OECD Principles of Corporate Governance*, April 1999. Section V., “Responsibilities of the Board,” of this report states “The board should be able to exercise

objective judgment on corporate affairs independent, in particular, from management. Boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgment to tasks where there is a potential conflict of interest. Examples of such key responsibilities are financial reporting, nomination and executive and board remuneration.”

Another key principle of corporate governance that is essential to the functioning of the internal controls over illegal acts is the board’s oversight of the integrity of the company’s systems for monitoring various matters including compliance with the law. Such systems include the establishment and maintenance of a corporate code of conduct. This point is also addressed in Section V. of the *OECD Principles of Corporate Governance*, which states, “The board should fulfill certain key functions, including ensuring the integrity of the corporation’s accounting and financial reporting systems, including the independent audit and that appropriate systems of control are in place, in particular, systems for monitoring risk, financial control, and compliance with the law.”

In summary, the task force observed that most countries do not have an explicit legal requirement that a company must maintain an adequate system of internal control. An important aspect of an internal control system is the existence of procedures which, if properly designed, will help ensure compliance with applicable laws and regulations. The task force believes that a legal requirement for an adequate system of internal controls is a key foundation for preventing and detecting illegal acts including bribery. However, we do not believe such requirements should be overly prescriptive of how internal controls are to be established, but rather should rely on judgment in light of the comprehensive frameworks that have been developed, as outlined in Appendix B. This belief is consistent with the second paragraph of the Commentaries on the Convention, adopted by the Negotiating Conference on November 21, 1997 which states, “This Convention seeks to assure a functional equivalence among the measures taken by the Parties to sanction bribery of foreign public officials, without requiring uniformity or changes in fundamental principles of a Party’s legal system.” The task force also believes that such requirements should address overall principles of corporate governance at least to the extent of requiring the inclusion of directors independent of management and the company as members of the corporate governing body, in particular the audit committee.

Observations Relating to Auditing Practices

Article 8 and Recommendation V. require countries to take measures relating to auditing standards.

Auditing standards in relation to illegal acts including bribery typically include measures to detect material misstatements in financial statements, which could result from illegal acts, and require reporting of known illegal acts including bribery to appropriate corporate governing bodies, such as an audit committee or corporate supervisory board. In addition, auditing standards typically require the auditor to obtain an understanding of the financial reporting internal control system, which may include internal control procedures designed to properly report in financial statements the consequences of compliance and material noncompliance with applicable laws and regulations, and report any detected material

weaknesses to the appropriate level within the company. Together with other auditing standards, these procedures help reduce the risk of bribery occurring and not being properly reported in the financial statements.

As stated in the discussion paper *The Accountancy Profession and the Fight Against Corruption* (Appendix D) prepared by IFAC, most national organizations of accountants, as well as IFAC, have developed a variety of standards that are designed to combat corruption. Such standards include auditing standards that require auditors to consider laws and regulations in an audit of financial statements and to communicate their findings to management and others charged with corporate governance as well as standards that require auditors to understand the accounting and internal control systems in conducting their audits. The relevant ISAs issued by the International Auditing Practice Committee (“IAPC”) of IFAC are summarized in Appendix C.

The ISAs relating to illegal acts, ISA 250 *Consideration of Laws and Regulations in an Audit of Financial Statements*, and internal controls, ISA 400 *Risk Assessment and Internal Control*, are particularly relevant to the OECD’s efforts to prevent or detect bribery of foreign public officials. While bribery and its prevention are not specifically mentioned in auditing pronouncements, there is significant guidance with respect to illegal acts. The task force believes both of these auditing standards could be enhanced to provide greater recognition of the need for robust corporate governance principles and internal control practices designed specifically to prevent or detect illegal acts including bribery, which are discussed above under “Observations Relating to Internal Controls.” Further, such enhancements to these auditing standards could help ensure that management and corporate monitoring bodies are made aware of significant weaknesses or absence of such internal control components as part of the annual audit. Organizations such as the OECD and TI should support such enhancements of the ISAs by the IAPC.

The task force’s survey revealed that requirements vary from country to country. Accordingly, the task force believes improved quality and greater consistency of audits could be achieved if all countries adopt the ISAs in their entirety as minimum auditing standards or modify existing standards relevant to illegal acts including bribery (discussed earlier and summarized in Appendix C) to meet or exceed the ISAs. Large global auditing firms have auditing methodologies and policies consistent with the ISAs and are committed to raising country auditing standards and practices to a common high standard based on the ISAs.

Observations Relating to Requirements for Audited Financial Statements

As stated in the 1997 Revised Recommendation, “Member countries should consider whether requirements to submit to external audit are adequate.” While assessing the effectiveness of each country’s requirements related to this recommendation was not within the scope of the task force’s project, the task force had certain observations relating to requirements for audited financial statements.

A legal requirement for audited financial statements can help provide assurance that the various requirements of Article 8 and Recommendation V. for books and records, internal controls and financial statement disclosures are effectively implemented and maintained. As discussed above in the section titled “Observations Relating to Auditing Practices,” most national organizations of accountants, as well as IFAC, have developed a variety of standards that are designed to combat corruption. The ISAs that are relevant to illegal acts including bribery are summarized in Appendix C. In addition, external audits generally provide an additional review and scrutiny of a company’s operations.

Based on information collected by the task force, the requirement for a company’s financial statements to be audited is generally based on a statutory size threshold or based on ownership attributes (companies that have publicly traded securities or that have debt held by third parties). As a result there may be a number of companies that are engaged in significant international business transactions that are not required to have an audit.

The requirement for audited financial statements by the country should be at a level that covers companies that have risk profiles with regard to bribery of foreign public officials. Companies having such a profile might include those that (1) have significant international operations and business activities, (2) conduct business in industries where bribing foreign public officials has been known to occur in the past, (3) are above a minimum size, or (4) have publicly traded securities or receive financing from third parties.

In summary, the task force believes that each country should review its requirements to determine that companies that have exposure to the bribery of foreign public officials are covered by legal annual audit requirements by independent auditors.

Observations Relating to Financial Statement Disclosures

While the task force did not do a detailed assessment of the adequacy of each country’s financial statement disclosure requirements relating to bribery, the task force had the following observations.

Article 8 and Recommendation V. require countries to take the necessary measures to fulfill the stated objectives of Article 8, including financial statement disclosures, within each signatory’s country. Specifically, the 1997 Recommendation states, “Member countries should require companies to disclose in their financial statements the full range of material contingent liabilities” which could include potential liabilities under the Convention relating to penalties pursuant to Articles 3 and 8, as well as other contingent losses that might flow from conviction of the company or its agents for bribery.

Accounting standards and practices vary from country to country as to the requirements for disclosure of material contingent liabilities which could include liabilities related to material bribes or known bribes which are likely to have a material effect on the company’s financial statements.

Each country’s financial statement disclosure requirements should include provisions that ensure quality and consistent disclosure of material contingent liabilities. One way of assessing whether a country’s

standards achieve such results is to compare the country's accounting standards and practices to existing internationally recognized standards. The International Accounting Standards (IASs), which are formulated and published by the International Accounting Standards Committee, include accounting standards and disclosure requirements for material contingent liabilities and could be used in performing such a comparison.

Specifically, IAS 37, *Provisions, Contingent Liabilities and Contingent Assets* (1998) covers the accounting and disclosure of material contingent liabilities. "The objective of this Standard is to ensure that appropriate recognition criteria and measurement bases are applied to provisions, contingent liabilities and contingent assets and that sufficient information is disclosed in the notes to the financial statements to enable users to understand their nature, timing and amount." The disclosure requirements of IAS 37 relating to contingent liabilities include the following:

Unless the possibility of any outflow in settlement is remote, an enterprise should disclose for each class of contingent liability at the balance sheet date a brief description of the nature of the contingent liability and, where practicable:

- (a) an estimate of its financial effect, measured under [the standard];
- (b) an indication of the uncertainties relating to the amount or timing of any outflow; and
- (c) the possibility of any reimbursement.

Even though the amount of a bribe may not be material, the consequences may, nonetheless, be severe. For example, adverse publicity or debarment from procurement. Therefore, evaluation of disclosure should take these considerations into account and not simply apply a rigid numerical test.

In summary, the task force believes improved quality and consistency of accounting and disclosure can be achieved if countries where accounting standards do not meet or exceed IASs, adopt IASs in their entirety as minimum accounting standards or at a minimum modify existing standards relevant to disclosure of contingent liabilities to meet or exceed the IAS.

In addition, ISA 250 *Consideration of Laws and Regulations in an Audit of Financial Statements*, discussed previously under "Observations Relating to Auditing Practices," provides the auditor with guidance on evaluating the possible effect on the financial statements of noncompliance with laws and regulations which could include bribery. As stated in ISA 250, "the auditor considers: the potential consequences, such as fines, penalties, damages, threat of expropriate of assets, enforced discontinuation of operations and litigation; whether the potential financial consequences require disclosure; and whether the potential financial consequences are so serious as to call into question the true and fair view (fair presentation) given by the financial statements." Further, ISA 250 states, "if the auditor concludes that the noncompliance has a material effect on the financial statements, and has not been properly reflected in the financial statements, the auditor should express a qualified or an adverse opinion."

As discussed under "Observations Relating to Auditing Practices," the task force believes all countries should adopt the ISAs in their entirety as minimum auditing standards or modify existing standards

relevant to illegal acts including bribery to meet or exceed the ISAs. Having such auditing standards should help ensure that companies' audited financial statements properly disclose the possible effects of noncompliance with laws and regulations.

Other Considerations for the OECD

Aside from assessing how each signatory country has implemented the Convention, the OECD and other interested parties, such as providers of finance (including public and private financial institutions, donors, and foundations), can contribute to the fight against bribery in other ways: by monitoring the initiatives related to enhancing accounting and auditing standards, and when appropriate, by providing support and constructive comments on such initiatives in order to help ensure that they include provisions that contribute to the fight against bribery and improve financial transparency and accountability in general.

Following is an outline of recommendations for the OECD related to current accounting and auditing initiatives and other measures:

International Level

- The OECD should provide constructive comments on the ISAs relating to illegal acts and internal control which are particularly relevant to the OECD's efforts to prevent or detect bribery of foreign public officials. These standards could be enhanced to provide greater recognition of the need for good corporate governance principles and internal control practices designed to prevent or detect illegal acts including bribery. More specifically the OECD should:
 - suggest improvements to the auditing standards relevant to illegal acts to help ensure that such standards specifically address the requirements of Article 8 and Recommendation V. to the greatest extent possible; and
 - suggest improvements to the standards relevant to internal control to help ensure that the auditor is required to communicate deficiencies in, for example:
 - Books and records
 - Controls related to illegal acts including bribery
 - Codes of Conduct

Member Country Level

- As previously stated in the earlier sections of this document, the OECD should recommend countries evaluate their accounting and auditing standards against IASs and ISAs as minimum standards. By looking to these international standards as a minimum benchmark, countries could focus on improvements to their existing standards.

Accounting Profession Initiatives

Following is a summary of various international accounting profession initiatives that are aimed at fighting corruption, and enhancing financial transparency and accountability in general. Many of these initiatives include measures that are consistent with those included in Article 8. As discussed in the previous section, the OECD should monitor these initiatives and provide comments, as appropriate, on standard setting proposals that come out of these initiatives.

IFAC - The Accountancy Profession and the Fight Against Corruption

IFAC is taking steps to promote the fight against corruption. These steps are included in its discussion paper, *The Accountancy Profession and the Fight Against Corruption* (Appendix D). This paper emphasizes that the accountancy profession can contribute to the fight against corruption as part of broader efforts by others.

This paper highlights the impact of corruption, sets out the role of national accountancy bodies in stimulating debate, and comments on how business professionals, corporate managers, legislators, and regulators can join with the accountancy profession in the effort to eradicate corruption.

IFAC's proposals to its member bodies include steps that are particularly relevant to the implementation of the Convention and are consistent with the observations of the TI task force. These proposals include:

- Developing programs that build collaborative relationships with legislative and regulatory authorities, the legal profession and other groups interested in strengthening the framework for good governance, transparency and accountability, as well as the legal framework, so as to minimize corrupt practices, propose solutions based on model legislation and regulations introduced in other countries and point out where swift action may be required.
- Encouraging practicing firms, their clients and governments to adopt codes of conduct setting the "tone at the top" by establishing sound principles of corporate governance that expressly prohibit corrupt activity, and that provide the benefits flowing from the implementation of internal control systems that help expose corrupt activities.

IFAC - Revisions to International Standards on Auditing

The IAPC is currently considering amendments to ISA 240, *Fraud and Error*, that are expected to contribute to increasing the auditor's performance in the area of fraud in conducting audits of financial statements and recognize that both management and those charged with corporate governance are key in the prevention and detection of fraud. Specifically, the revised standard is anticipated to address the following auditor performance matters: inquiries of management, consideration of fraud risk factors, consideration of detected errors for indication of existence of fraud, communications (including those

relating to weaknesses in internal controls), documentation requirements, and heightened professional skepticism.

International Forum on Accountancy Development (IFAD)

IFAD, composed of representatives of IFAC, the regional accountancy organizations, the international financial institutions, the regulators, and the Big 5 firms, was established in 1999. Its objectives are as follows:

- Promote understanding by national governments of developing countries and economies in transition about the value of transparent financial reporting, in accordance with sound corporate governance by various parties served by the accountancy profession;
- Assist in defining expectations as to how the accountancy profession (in both the public and private sectors) should carry out its responsibilities to support the public interest in developing countries;
- Serve to bring pressure on governments to focus more directly on the needs of developing countries;
- Help harness funds and expertise to build accounting and auditing capacity in developing countries;
- Promote cooperation between governments, the profession, the international financial institutions, regulators, standard-setters, capital providers and issuers; and
- Contribute to a common strategy/framework of reference for accountancy development.

Additional information on IFAD is included in the article entitled *International Forum Focuses on Accountancy Development* (Appendix E), including discussions about the development of two papers “which will seek to persuade governments, particularly in developing and transitional countries, of the importance of achieving greater accountability and transparency in financial reporting in both private and public sectors.”

Major Firms Initiatives

The major accounting firms have been working together on a project aimed at improving worldwide standards of accounting, reporting and auditing. The key proposals of the firms include the following:

- To use International Accounting Standards as the benchmark for raising national accounting standards and practices;
- To raise auditing standards and practices to a common high standard based upon IFAC’s standards; and
- To enforce globally within their own firms a code of conduct on independence issues based on IFAC’s code.

The firms plan on cooperating with IFAC and IFAD to implement and monitor the initiatives. Additional information about the firms' initiatives is included in the article entitled *Major Firms Demonstrate Commitment to Accountancy Development* (Appendix F).

IASC Restructuring

The objective of the International Accounting Standards Committee (IASC) is to achieve uniformity in the accounting principles that are used by businesses and other organizations for financial reporting around the world. This, in turn, improves the ability of investors, creditors, governments, and others to make informed resource allocation and policy decisions.

In response to widespread support for the need for change in the IASC's current structure, the IASC's Board has approved a plan for restructuring, subject to ratification by its membership. See the report of the IASC Strategy Working Party, *Recommendations on Reshaping IASC for the Future*, November 1999, available at the IASC website iasc.org.uk. The primary objective of the restructuring is working toward convergence to a set of global standards that require high quality, transparent, and comparable information. The proposed restructuring plan is expected to result in an independent board whose members are selected based on technical expertise, with oversight provided by an independent set of Trustees. The restructuring also is expected to integrate the roles of the IASC and those of national standard-setters.

U.S. Securities and Exchange Commission (SEC)

On February 16, 2000, the SEC issued for public comment a concept release regarding the use of international accounting standards. The release seeks feedback from domestic and foreign parties regarding both acceptance of International Accounting Standards Committee standards and the broader issue of shaping a global financial structure for increasingly globalized capital markets.

The release is available on the SEC website at <http://www.sec.gov/rules/concept/34-42430.htm>.

The release solicits comment regarding the quality of the IASC standards and raises questions regarding what supporting infrastructure is necessary in an environment where issuers and auditors often are multinational organizations, providing financial information in many countries. The release seeks to identify what important concerns would be raised by acceptance of IASC standards; and then asks for comment on whether the SEC should modify its current requirement for all financial statements to be reconciled to US GAAP.

A 90-day public comment period commenced on February 23, 2000, upon publication of the release in the Federal Register.

Appendix A

Relevant OECD Authorities

Article 8 of the Convention

Article 8 requires parties to prohibit off-the-book accounts and other measures to hide bribes and to provide effective penalties for falsification of books and records. It states that:

1. In order to combat bribery of foreign public officials effectively, each Party shall take such measures as may be necessary, within the framework of its laws and regulations regarding the maintenance of books and records, financial statement disclosures, and accounting and auditing standards, to prohibit the establishment of off-the-books accounts, the making of off-the-books or inadequately identified transactions, the recording of non-existent expenditures, the entry of liabilities with incorrect identification of their object, as well as the use of false documents, by companies subject to those laws and regulations, for the purpose of bribing public officials or of hiding such bribery.
2. Each Party shall provide effective, proportionate and dissuasive civil, administrative or criminal penalties for such omissions and falsifications in respect of the books and records, accounts and financial statements of such companies.

Recommendation V. of the 1997 Revised Recommendation

The 1997 *Revised Recommendation on Combating Bribery in International Business Transactions* (“1997 Revised Recommendation”) sets out measures that countries should take with respect to the field of accounting. These measures require companies to maintain adequate accounting records, adopt internal company controls, and undergo external audits. The following recommendations, which are included in the 1997 Revised Recommendation, are subject to follow-up by the OECD's Anti-Bribery Working Group:

Accounting Requirements, External Audit and Internal Company Controls

V. **RECOMMENDS** that Member countries take the steps necessary so that laws, rules and practices with respect to accounting requirements, external audit and internal company controls are in line with the following principles and are fully used in order to prevent and detect bribery of foreign public officials in international business.

A. Adequate accounting requirements

i) Member countries should require companies to maintain adequate records of the sums of money received and expended by the company, identifying the matters in respect of which the receipt and expenditure takes place. Companies should be prohibited from making off-the-books transactions or keeping off-the-books accounts.

ii) Member countries should require companies to disclose in their financial statements the full range of material contingent liabilities.

iii) Member countries should adequately sanction accounting omissions, falsifications and fraud.

B. Independent External Audit

i) Member countries should consider whether requirements to submit to external audit are adequate.

ii) Member countries and professional associations should maintain adequate standards to ensure the independence of external auditors which permits them to provide an objective assessment of company accounts, financial statements and internal controls.

iii) Member countries should require the auditor who discovers indications of a possible illegal act of bribery to report this discovery to management and, as appropriate, to corporate monitoring bodies.

iv) Member countries should consider requiring the auditor to report indications of a possible illegal act of bribery to competent authorities.

C. Internal company controls

i) Member countries should encourage the development and adoption of adequate internal company controls, including standards of conduct.

ii) Member countries should encourage company management to make statements in their annual reports about their internal control mechanisms, including those which contribute to preventing bribery.

iii) Member countries should encourage the creation of monitoring bodies, independent of management, such as audit committees of boards of directors or of supervisory boards.

iv) Member countries should encourage companies to provide channels for communication by, and protection for, persons not willing to violate professional standards or ethics under instructions or pressure from hierarchical superiors.

OECD Principles of Corporate Governance, April 1999

The principles include responsibilities for those charged with corporate governance relating to

compliance with laws and internal controls which are particularly relevant in the fight against illegal acts including bribery of foreign public officials. Following are Sections IV. and V. of the document:

IV. Disclosure and transparency

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

- A. Disclosure should include, but not be limited to, material information on:
 - 1. The financial and operating results of the company.
 - 2. Company objectives.
 - 3. Major share ownership and voting rights.
 - 4. Members of the board and key executives, and their remuneration.
 - 5. Material foreseeable risk factors.
 - 6. Material issues regarding employees and other stakeholders.
 - 7. Governance structures and policies.
- B. Information should be prepared, audited, and disclosed in accordance with high quality standards of accounting, financial and non-financial disclosure, and audit.
- C. An annual audit should be conducted by an independent auditor in order to provide an external and objective assurance on the way in which financial statements have been prepared and presented.
- D. Channels for disseminating information should provide for fair, timely and cost-efficient access to relevant information by users.

V. The responsibilities of the board

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

- A. Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.
- B. Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.
- C. The board should ensure compliance with applicable law and take into account the interests of stakeholders.
- D. The board should fulfill certain key functions, including:
 - 1. Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and

- corporate performance; and overseeing major capital expenditures, acquisitions and divestitures.
2. Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.
 3. Reviewing key executive and board remuneration, and ensuring a formal and transparent board nomination process.
 4. Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.
 5. Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for monitoring risk, financial control, and compliance with the law.
 6. Monitoring the effectiveness of the governance practices under which it operates and making changes as needed.
 7. Overseeing the process of disclosure and communications.
- E. The board should be able to exercise objective judgment on corporate affairs independent, in particular, from management.
1. Boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgment to tasks where there is a potential for conflict of interest. Examples of such key responsibilities are financial reporting, nomination and executive and board remuneration.
 2. Board members should devote sufficient time to their responsibilities.
- F. In order to fulfill their responsibilities, board members should have access to accurate, relevant and timely information.

Appendix B

Internal Controls - Available Resources (Synopsis)

The Combined Code: Internal Control-Guidance for Directors on the Combined Code, September 1999 (The Institute of Chartered Accountants in England & Wales)

This publication provides guidance for directors on the implementation of Principle D.2 of the Combined Code and its associated Provisions D.2.1 and D.2.2 (see below, the *Committee on Corporate Governance - The Combined Code*, June 1998).

International Chamber of Commerce: Fighting Bribery - A Corporate Practices Manual, April 1999

This book is intended as a practical handbook for corporate managers, lawyers and accountants, responsible for developing and administering corporate compliance programs. It serves as commentary on the ICC Rules and the OECD Convention. The following excerpt from the book summarizes the need for an effective internal control system once the appropriate policies have been adopted:

Companies must then design the managerial and accounting procedures and controls that are needed to implement their anti-bribery policies, and develop or modify their internal control systems to ensure the effectiveness of these procedures and controls.

The Combined Code: Committee on Corporate Governance - The Combined Code, June 1998 (The London Stock Exchange)

This report includes “principles of good governance and code of best practice.” Companies listed on the London Stock Exchange are required to disclose how they have applied the principles and the extent to which they have complied with the detailed provisions of the Combined Code in their annual reports. Principle D.2, Internal Control, states that “the board should maintain a sound system of internal control to safeguard shareholders’ investment and the company’s assets.”

IIA: Control Model Implementation: Best Practices, 1997 (The Institute of Internal Auditors Research Foundation)

The study presents a collection of successful practices from which readers can draw upon to fashion the best approaches in control implementation that are truly "best" in their own organization.

Groundwork for the research of this project was laid by *Internal Control - Integrated Framework* by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and to a lesser extent, by *Guidance on Control* by the Criteria of Control Board of the Canadian Institute of Chartered Accountants (CoCo). Offering a conceptual framework, both were considered control models in this best practices report.

CoCo: *Guidance on Control-Control and Governance - Number 1*, November 1995 (The Canadian Institute of Chartered Accountants)

This guidance is intended to help improve control. It describes and defines control (going well beyond a discussion of traditional internal accounting controls) and sets out criteria for effective control in an organization. It provides a framework that people throughout an organization can use to develop, assess and change control.

The King Report: *The King Report on Corporate Governance*, November 1994 (The Institute of Directors in Southern Africa)

The purpose of the report is to promote the highest standards of corporate governance in South Africa. The recommendations and related discussions address the board of director's responsibility to ensure that the company has adequate systems of internal controls both operational and financial, and address the need to implement, update and monitor compliance with a "Code of Corporate Practices and Conduct" which sets for ethical business practices.

COSO: *Internal Control - Integrated Framework*, 1992 (Committee of Sponsoring Organizations of the Treadway Commission, United States)

The definition of internal control established in the COSO report is, "Internal control is a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: effectiveness and efficiency of operations; reliability of financial reporting and compliance with applicable laws and regulations."

Appendix C

Summary of Certain International Standards on Auditing

- ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*. The purpose of this ISA is to establish standards and provide guidance on the auditor's responsibility to consider laws and regulations in an audit of financial statements. When planning and performing audit procedures and in evaluating and reporting the results thereof, the auditor should recognize that noncompliance by the entity with laws and regulations may materially affect the financial statements. However, an audit cannot be expected to detect noncompliance with all laws and regulations. Detection of noncompliance, regardless of materiality, requires consideration of the implications for the integrity of management or employees and the possible effect on other aspects of the audit.

This standard provides the auditor guidance on reporting of noncompliance to management (the audit committee, the board of directors and senior management), users of the auditor's report on the financial statements, and regulatory and enforcement authorities.

- ISA 400, *Risk Assessment and Internal Control*. The purpose of this ISA is to establish standards and provide guidance on obtaining an understanding of the accounting and internal control systems and on audit risk and its components: inherent risk, control risk and detection risk. The auditor should obtain an understanding of the accounting and internal control systems sufficient to plan the audit and develop an effective audit approach. The auditor should use professional judgment to assess audit risk and to design audit procedures to ensure it is reduced to an acceptably low level.

Communications of Weaknesses. As a result of obtaining an understanding of the accounting and internal control systems and tests of control, the auditor may become aware of weakness in the systems. The auditor should make management aware, as soon as practical and at an appropriate level of responsibility, of material weaknesses in the design or operation of the accounting and internal control systems, which have come to the auditor's attention.

- ISA 730, *Communications of Audit Matters With Those Charged With Governance*. The purpose of this ISA is to establish standards and provide guidance on communication of audit matters arising from the audit of financial statements between the auditor and those charged with governance of an entity. These communications relate to audit matters of governance interest as defined in this ISA. This ISA does not provide guidance on communications by the auditor to parties outside the entity, for example, external regulatory, or supervisory agencies. The auditor should communicate audit matters of governance interest arising from the audit of financial statements with those charged with governance of an entity. Ordinarily such matters include material weaknesses in internal control, questions regarding management integrity, and fraud involving management.

This ISA is effective for audits of financial statements for periods ending on or after December, 31 2000.

Information About IFAC

Organization Overview

The International Federation of Accountants (“IFAC”) is an organization of national professional accountancy organizations that represent accountants employed in public practice, business and industry, the public sector, and education, as well as some specialized groups that interface frequently with the profession. Currently, it has 128 member bodies in 91 countries, representing two million accountants.

Objective

IFAC strives to develop the profession and harmonize its standards worldwide to enable accountants to provide services of consistently high quality in the public interest.

International Standards on Auditing (ISAs)

These standards, developed by the International Auditing Practice Committee (“IAPC”) of IFAC, outline basic responsibilities for auditors, help them cope with increased and changing demands for financial statement information, and provide guidance in specialized areas, such as auditing computer information systems.

International Auditing Practice Statements (IAPs)

These statements, also developed by the IAPC, provide practical assistance to auditors in implementing the standards or on related subjects and promote good practice.

Appendix D

The Accountancy Profession and the Fight Against Corruption

A Discussion Paper

Excerpted from IFAC Council Developments, Web Site <http://www.ifac.org>.

This paper has been developed by the International Federation of Accountants (IFAC) to promote debate at the national and global levels on the issue of corruption. It highlights the impact of corruption, sets out the role of national accountancy bodies in stimulating debate, and comments on how business professions, corporate managers, legislators, and regulators can join with the accountancy profession in the effort to eradicate corruption.

The Impact of Corruption

1. As trade and investment become global, concerns about corruption are also global. The problem of corruption can no longer be dismissed as a local condition. There is corruption, public and private, in all countries, although, in some, it may be more obvious than in others. This has a negative impact on everyone; economic development is hampered, investors lose confidence, entrepreneurs suffer increased costs of doing business and higher risks, country credit ratings drop, the credibility of professionals, businesspersons and government is greatly diminished, and society at large loses self esteem and has less confidence in the rule of law and in institutions in general. The resulting drop in aid and investment, both domestic and foreign, may well have a significant impact on economic development, thus creating social hardship, particularly in developing and emerging countries.

Legal and Governmental Support

2. The fight against corruption must be carried on by all and at all levels of society. It requires a commitment by governments and the existence of a solid framework of laws, regulations, control systems and disciplinary measures that proscribe corrupt acts and prescribe strong penalties for those found guilty of them. Further, laws are needed to protect those who fulfill their moral and perhaps legal obligation to take positions against corruption which may include the reporting of corrupt acts, i.e., "blowing the whistle."
3. The accountancy profession cannot fight this battle alone but, as an integral part of society and a major player in the business world, it must be and is ready to play its part. If the requisite infrastructure is in place and there is appropriate public support, the profession can and will participate alongside members of the other business professions and institutions both in the public and private sectors.
4. There is in each country a need to understand what comprises corruption since corrupt acts take many forms. They may include bribery, fraud, illegal payments, money laundering, smuggling and as many other forms as criminal minds may devise. Often corruption takes place not involving money, but special favors or influence. Economic growth, globalization and new developments in technology provide a changing scenario in which corrupt individuals devise ever-changing forms of corruption. Consequently, any fight against corruption must cover a wide range of issues and possibilities. It is impossible to provide an all-purpose rule book on how to contain corruption. The problem is too complex.

The Need for Strong Corporate Governance

5. In the business world, management has a critical role in the fight against corruption. It is the management of an organization that will set the "tone at the top" and develop and enforce systems of proper corporate governance. Corruption will find it difficult to take root in a system which contains the proper controls and in which corporate governance supports such controls and restricts management override. In the public sector, similar governance codes have been or need to be developed.
6. Accountants have long been characterized for high integrity and objectivity as well as for their service to the public interest. They hold key internal positions in organizations in the public and private sectors, as well as responsibilities as external auditors or advisors. Their responsibilities cannot be expected to be primarily that of watchdogs against corruption or law enforcement officers, but their strategic positions in the enterprise, coupled with their integrity, objectivity and vocation to protect the public interest, make them essential players in the efforts of society to reduce corruption.

Accountancy Profession Initiatives

7. Most national organizations of accountants, as well as the International Federation of Accountants, have developed a variety of standards that are designed to combat corruption. Ethics codes, which apply to all accountants, be they in public practice, business, industry or government, require them to follow the highest standards of objectivity and professional care. Auditing standards alert practitioners to the possibility of fraud and require them to document such possibility in planning audits and to report their findings to management. Codes of corporate governance and appropriate financial and other internal controls should ensure that those accountants in business or in government are aware of their responsibilities to report corruption in a similar manner.
8. While it might be considered that accountants should report acts of corruption to external authorities (e.g. regulators, public prosecutors, the police), this would be an unreasonable burden without the requisite legal infrastructure being enacted, the equivalent obligations being placed on the other business professions and institutions, and the public being supportive of the requirement.
9. IFAC therefore wishes to contribute to the global and national debates which it believes should be developed in order to ensure that the fight against corruption be progressed, with the members of the accountancy profession playing their full part as set out above. To that end:
 - It has developed this paper to raise awareness of the issues and contribute to the debate.
 - It will propose to its 143 member bodies in 104 countries that they
 - Develop programs that build collaborative relationships with legislative and regulatory authorities, the legal profession and other groups interested in strengthening the framework for good governance, transparency and accountability, as well as the legal framework, so as to minimize corrupt practices, propose solutions based on model legislation and regulations introduced in other countries and point out where swift action may be required;

- Work with government to ensure that the requisite definition of corruption is in place, the legislation proscribing corrupt acts is prepared and appropriate means of protection are developed for those who may "blow the whistle;"
- Initiate education programs for accountants and the public to create awareness of the detrimental effects of corruption, thereby motivating public action toward its elimination, through press articles, seminars, continuing professional education courses and speeches by leaders of the profession;
- Encourage the national media to make corruption a public issue by devoting attention to the types and hazards of corrupt activities, publication of studies of the harm caused by corruption and the various steps that can be taken to prevent or expose such harm;
- Provide assistance including technical support to national and international organizations fighting corruption by publicizing their activities, offering assistance in their research and promoting their proposals;
- Encourage practicing firms, their clients and governments to adopt codes of conduct setting the "tone at the top" by establishing sound principles of corporate governance that expressly prohibit corrupt activity, and that provide the benefits flowing from the implementation of internal control systems that help expose corrupt activities;
- Encourage audit committees expressly to consider whether appropriate policies are in place to prohibit corrupt acts and to require that any such act be reported to them; and
- Promote a tax system which is efficient and equitable so as to discourage the disparity and burden that leads to corruption and which does not allow corrupt payments to be deductible from income for tax purposes;
- It will use its influence with organizations such as the World Bank, the IMF, the OECD and the United Nations to encourage the development of proper legislation in all member states; and
- It will establish and maintain links with organizations such as Transparency International and the Financial Action Task Force to ensure that the profession is represented in their governing councils and periodic conferences as a means to increase its profile in the fight against corruption

10. Ultimately, it is the individual accountant who must carry out his/her responsibility in the anticorruption campaign. Professional skepticism is necessary when establishing business relationships and in the review of transactions between related parties, especially when they appear to have questionable business sense. Corrupt entities and individuals must realize that accountants constitute a barrier against corruption. Above all, each individual accountant must ensure that his/her own behavior should reflect an unswerving commitment to truth and honesty in financial reporting.

Appendix E

International Forum Focuses on Accountancy Development

Excerpted from *IFAC News and Views*, Web Site <http://www.ifac.org>.

The second meeting of the International Forum on Accountancy Development took place in October in Paris, France under the chairmanship of IFAC President Frank Harding. Forum participants, who include representatives of international financial institutions, large accountancy firms, and international regulatory groups, discussed two papers:

- "The Country Disclosure," prepared by Jules Muis, Deputy Chairman of the World Bank, which describes frameworks, designed to identify the extent to which any given nation has in place the sound financial framework and governance necessary to protect the public interest and fight corruption; and
- "The Role of the Accountant in the International Financial Framework," prepared by Richard Findlater, of Ernst and Young, which explains the central role of the profession in the framework proposed by Mr. Muis.

The development of these two papers is a significant first step in preparing proposals for submission to governments and others to contribute to the creation of sound institutional frameworks. Council members had a preliminary discussion of these papers at their November meeting. They will provide further input at a special IFAC Council meeting in January 2000.

Member Body Survey

More than 70 member bodies have responded to IFAC's survey, "Reporting of National Practices and Conformity with IFAC/IASC." So that we may begin work on a comprehensive report of the results, member bodies that have not yet done so are urged to send their responses to Maria Hermann at IFAC. They may be faxed to 1-212-286-9570. Allied to this survey is the creation by the Council of a Compliance Committee that will monitor and report on levels of compliance throughout the membership of IFAC and offer help and guidance to member bodies in this area. Member bodies have been asked to submit nominations for this new committee for approval by the Council at its May 2000 meeting.

PSC Standards Project Update

The Public Sector Committee received more than 50 submissions to its Invitation to Comment:

The Development of International Public Sector Accounting Standards: Which Bases of Accounting? The Invitation to Comment sought the views of constituents on a number of proposals in relation to the future development of International Public Sector Accounting Standards (IPSASs). The submissions indicated widespread support for the PSC's proposal to develop standards for the cash basis of accounting and the accrual basis of accounting only, as well as for other PSC proposals related to standard setting. The Standards Subcommittee considered the submissions at its October meeting and the full PSC will consider them at its meeting in January 2000. Once the PSC has finalized its approach to developing IPSASs, the outstanding EDs will be finalized. The first set of final pronouncements is

expected to be released around May 2000.

IFAC's Structure and Organization

During the Council meeting, there was further debate on various aspects of the proposed constitutional changes contained in the report of the Structure and Organization Task Force (SOTF). Among other issues, it was agreed that the titles of the President and Deputy President should not be changed to Chairman and Deputy Chairman. However, it was agreed that the title of Director General be changed to Chief Executive. This will be among the changes put forward to the General Assembly for approval in May 2000. In addition, the new constitution, incorporating the principal changes recommended by the SOTF and adopted by the Council, is being prepared in final form for submission to the Assembly.

IAPC Developments

At its meeting in October, the IAPC agreed to develop a new statement on auditing derivatives. The project will be put on a fast track so that an exposure draft can be issued in mid-2000.

In addition, IAPC and IFAC's IT Committee are in the process of developing a proposal on e-commerce. The proposal is being developed from the perspective of all technical committees, as e-commerce impacts all of their work.

A Consultative Group meeting was held in November in Paris. Representatives of IOSCO, the Basle Committee on Banking, the European Commission Committee on Auditing, the European Federation of Accountants and Auditors for small/medium sized enterprises, FEE, the Institute of Internal Auditors, UNCTAD, and ISACA participated in the meeting, providing comments to the IAPC on some of the directions it is taking.

New IT Guidance Designed to Help Management

- The IT Committee has recently released an IT Executive Checklist to help executives increase the success of their IT projects and keep costs under control. The Checklist provides key questions senior managers should ask before authorizing investment in an information technology project and the related communications support. The Checklist may be viewed on IFAC's Web site, www.ifac.org, or obtained from the IFAC Secretariat.
- Two new guidelines, Acquiring Information Technology and Implementation of Information Technology Solutions have been added to the series of guidelines developed by IFAC's IT Committee. They contain information to assist executives with the management of information technology systems and contribute to the overall success of such systems. They will be viewable on IFAC's Web site by December 31, 1999.

Ethics Forum

An Ethics Forum, focusing in particular on issues and rules of independence, was held in Rome in November. An exposure draft focusing on independence will be issued during the coming year.

Framework of International Aid Projects

The Education Committee is in the process of finalizing a new study on assistance projects in accountancy education and development. The study draws from the experience of professional bodies in assisting the accounting profession or governments in other countries and pinpoints some of the major lessons learned from such projects. It should provide useful information for professional bodies intending to offer assistance to, or receive assistance from, other bodies or experts in accounting education in the

future. Quality Issues for Internet and Distributed Learning in Accounting Education A new discussion paper dealing with the quality issues for Internet and distributed learning in accounting education is currently under development. The discussion paper raises issues that professional bodies (and other stakeholders) face when considering the recognition of pre- and post-qualification education from non-traditional sources. The Education Committee plans to release this paper within six months.

Appendix F

Major Firms Demonstrate Commitment to Accountancy Development

Excerpted from the IFAC Quarterly, October 1999, Web Site <http://www.ifac.org>.

The first full meeting of the International Forum on Accountancy Development (IFAD) took place under the chairmanship of the President of IFAC in New York on June 14-15. Representatives of the accountancy profession, the international funding institutions and development agencies and the Big Five accounting firms participated. Forum participants approved an outline constitution and agreed that its first task should be the preparation of two papers which will seek to persuade governments, particularly in developing and transitional countries, of the importance of achieving greater accountability and transparency in financial reporting in both private and public sectors.

Public and Private Sector Partnership Is Vital

However, perhaps the most significant aspect of the meeting was a presentation made by Jacques Manardo speaking on behalf of the major firms. He outlined the firms' vision for enhancing the quality of services provided by the accounting profession, both in developing and developed countries and in the public and private sectors. Specifically, he reported the commitments the firms were prepared to make to improving the performance of the profession and thus promoting the quality and objectivity of financial reporting. He called for others, including governments, regulators, standard-setters and those who prepare and issue financial statements, to contribute towards the achievement of this "vision" and suggested that, with this shared commitment, the quality, consistency and credibility of reporting could and would be improved.

Firm Initiatives

The accounting firms made a commitment to undertake the following significant actions:

- To respond to the continually evolving needs of the capital markets and the investing public;
- To take a leadership role in identifying necessary changes;
- To work closely with all interested parties in implementing change;
- To contribute jointly to training and other activities to implement the vision;
- To move ahead rapidly on implementing those changes which are within their own control.

The key proposals of the firms were:

- To use International Accounting Standards as the benchmark for raising national accounting standards and practices;
- To raise auditing standards and practices to a common high standard based upon IFAC's standards;
- To enforce globally within their own firms a code of conduct on independence issues based on IFAC's code;
- To use IFAD to implement change in the developing and emerging nations.

In addition, the firms put forward proposals, to be developed in cooperation with IFAC and IFAD, for implementing and monitoring the vision.

The firms' presentation was in part developed in response to questions raised in recent months regarding the appropriateness of accounting methods used by many of the firms' clients and the adequacy of the audit approach and reporting of the firms themselves. Their response thus included proposals that they would:

- "Support a narrative in the financial statements of the differences between national and international standards and include an explanatory paragraph in our audit reports," and
- "Identify national or international auditing standards in our audit reports and include an appropriate explanatory paragraph where national auditing standards differ significantly from international standards."

In making these commitments, the firms have put their heads above the metaphorical parapet. While it is true that the success of their vision will depend upon the readiness of others also to participate in its development and in the changes it requires, the firms will nevertheless be judged by their own ability to match their achievements to their commitments. They are to be complimented for publicly committing themselves and for confirming their preparedness to work with IFAC and IASC towards this goal.

Appendix G

Project Description and Methodology

The task force established a process to collect data for the countries selected for review. The task force created a standard template that was designed to capture information within the countries particularly relevant to the objectives of Article 8 (books and records, internal controls, and auditing practices) and Recommendation V. The template was designed to be completed regardless of the status of a country's ratification of the Convention or implementation of related laws and regulations. This was done since some of the countries that have taken such steps did so by amending or modifying their existing laws and regulations. In addition, the template was designed to allow for subsequent analysis of the information by including requests for copies of the actual laws, regulations and other supporting materials.

In order to ensure that meaningful information was collected, a list of questions was developed to complement the template. These probing questions were categorized by the areas being reviewed (books and records, internal controls, and auditing practices).

The templates were sent to representatives in the respective countries to complete. In addition to the templates and the list of questions discussed above, other information was provided such as a copy of the Convention and a link to the OECD website which provides information about the legislative measures undertaken by countries to ratify and implement the Convention and links to national implementing legislation (<http://www.oecd.org/daf/nocorruption/instruments.htm>).

While the information is believed to be accurate there is the possibility that it may not be complete or reflect recent developments within the countries

The information for the countries was summarized as well as analyzed for compliance with Article 8 and Recommendation V. Specific observations were noted where the laws, regulations or practices did not appear to fulfill the requirements of Article 8 and Recommendation V. These observations are included in a separate report entitled, "Country Analysis and Observations."