ADB/OECD Anti-Corruption Initiative for Asia and the Pacific

CORPORATE MEASURES TO PREVENT AND DETECT CORRUPTION IN ASIA AND THE PACIFIC

Frameworks and Practices in 31 Jurisdictions

Thematic Review – Final Report

ADB

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Frameworks and Practices in 31 Jurisdictions

Thematic Review – Final Report

Afghanistan – Australia – Bangladesh – Bhutan – Cambodia – P.R. China
Cook Islands – Fiji Islands – Hong Kong, China – India – Indonesia
Japan– Republic of Kazakhstan – Republic of Korea – Kyrgyz Republic
Macao, China – Malaysia – Mongolia – Nepal – Pakistan – Palau
Papua New Guinea – Philippines – Samoa – Singapore – Solomon Islands
Sri Lanka – Timor-Leste – Thailand – Vanuatu – Viet Nam

Asian Development Bank

Organisation for Economic Co-operation and Development

Publications of the ADB/OECD Anti-Corruption Initiative for Asia and the Pacific

- Corporate Measures to Prevent and Detect Corruption in Asia and the Pacific, Manila: ADB/OECD, 2014.
- Fighting Corruption and Building Trust: Proceedings of the 8th Regional Anti-Corruption Conference. Manila: ADB/OECD, 2014.
- Building Multidisciplinary Frameworks to Combat Corruption: Proceedings of the 7th Regional Anti-Corruption Conference: Paris, ADB/OECD, 2011.
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- Asset Recovery and Mutual Legal Assistance in Asia and the Pacific: Proceedings of the 6th Regional Technical Seminar. Paris: ADB/OECD, 2008.
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These documents are available for download from the Initiative's Web site at www.oecd.org/site/adboecdanti-corruptioninitiative/publications.htm.

This publication was prepared by J. Patrick Meagher on behalf of the ADB/OECD Anti-Corruption Initiative for Asia and the Pacific under the supervision of its Secretariat, composed of Asian Development Bank (ADB) and Organisation for Economic Co-operation and Development (OECD) staff.

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NOTES

[1] India and Kazakhstan were unable to review and comment on their draft reports in time for this publication. Their reports will be added to the publication when finalized.

Main Abbreviations and Acronyms

ACA	Anti-Corruption Agency
ACC	Anti-Corruption Commission
ACU	Anti-Corruption Unit
ADB	Asian Development Bank
APESB	Accounting Professional and Ethical Standards Board
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CGDC	Corporate Governance Development Code
CPA	Certified Public Accountant
EITI	Extractive Industries Transparency Initiative
FATF	Financial Action Task Force
GAAP	Generally Accepted Accounting Principles
IAS	International Accounting Standards
ICA	Institute of Chartered Accountants
ICAC	Independent Commission Against Corruption
IFC	International Finance Corporation
IFRS	International Financial Reporting Standards
IIA	Institute of Internal Auditors
ISA	International Standards of Audit
MOU	Memorandum of Understanding
NGOs	non-government organizations
OECD	Organisation for Economic Co-operation and Development
SEC	Securities and Exchange Commission
SMEs	small- and medium-sized enterprises
TI	Transparency International
UK	United Kingdom
UNCAC	United Nations Convention against Corruption
UNODC	United Nations Office on Drugs and Crime
US	United States
USD	United States Dollar

Foreword

The ADB/OECD Anti-Corruption Initiative for Asia and the Pacific (the "Initiative") was established in 1999 with the support of the Asian Development Bank (ADB) and the Organisation for Economic Co-operation and Development (OECD). The Initiative is a regional network through which members cooperate in the fight against corruption.

A total of 31 Asian and Pacific jurisdictions have endorsed the Initiative's Action Plan and committed to taking concrete actions toward implementing reforms to deter, prevent, and combat corruption. The Initiative's Steering Group, comprised of the member jurisdictions, defines the Initiative's priorities and activities, which are guided by the Strategic Principles and Future Activities of the Initiative, adopted in 2010. For the Thematic Reviews, the Steering Group in each case chooses an area of anti-corruption activity for analysis, following the Initiative's Strategic Principles.

The Review assesses each Initiative member's anti-corruption efforts in the chosen area, identifies challenges facing each member, and makes recommendations for overcoming these difficulties. The Review also identifies trends and common obstacles that cut across the Asia-Pacific region. The Review's final report consists of individual reports on each member of the Initiative, and a horizontal report on regional trends and obstacles. Members are invited to provide written comments on multiple drafts of the report. Each country report is finalized with that country's input and approval. The final report is then discussed and adopted at a Steering Group meeting. It is also published on the Initiative's website and in print. Two years after the completion of a Thematic Review, members are asked to report the steps that have been taken to implement the Review's recommendations. Thereafter, in their periodic self-reports, members are expected to discuss any further steps taken to implement the recommendations.

The Initiative's past three Thematic Reviews covered the following topics: Curbing Corruption in Public Procurement (2006); Mutual Legal Assistance, Extradition and Recovery of Proceeds of Corruption (2007); and Criminalization of Bribery Offences (2010). At its 15th Meeting in September 2010, the Steering Group agreed to conduct a Thematic Review on Corporate Compliance, Ethics and Internal Controls, Including Accounting and Auditing Measures for Preventing and Detecting Corruption. At its 17th Meeting in October 2012, the Steering Group agreed that the Thematic Review should commence in 2013 and be completed by the 19th Steering Group Meeting in 2014.

This Thematic Review Report was prepared by J. Patrick Meagher, consultant to the secretariat of the ADB/OECD Anticorruption Initiative for Asia and the Pacific, with comments by William Loo, Joydeep Sengupta and Elizabeth Owen at the Anti-Corruption Division, Directorate for Financial and Enterprises Affairs, OECD, and Elizabeth Fischelis at the Poverty Reduction, Social Development and Governance Division, Regional and Sustainable Development Department, ADB. It was copyedited by Marilyn Pizarro, consultant to the secretariat. The Report was adopted by the Initiative's Steering Group at its 19th Steering Group meeting in September 2014.

Scope and Methodology

The global economic news reminds us daily of the need for companies to institute safeguards against corruption. This Thematic Review focuses on the status of measures taken in this area by member states of the ADB/OECD Anti-Corruption Initiative for Asia and the Pacific. Specifically, the Review deals with implementation of the articles on private sector-related corruption contained in the UN Convention against Corruption[1] (art.12) and the OECD Anti-Bribery Convention[2] (art.8). In this field, the overarching duty for each member state of the Initiative is set forth in UNCAC (art.12(1)):

> Each State Party shall take measures, in accordance with the fundamental principles of its domestic law, to prevent corruption involving the private sector, enhance accounting and auditing standards in the private sector and, where appropriate, provide effective, proportionate and dissuasive civil, administrative or criminal penalties for failure to comply with such measures.

From this primary duty flow the other obligations, stated in UNCAC (arts.12-13) and in the OECD Anti-Bribery Recommendation[3] (rec. X): to promote state-private cooperation; develop standards of good corporate governance, ethical business practice, and integrity in the accounting and audit professions; ensure that businesses have sufficient audit and internal controls to prevent and detect corruption; and prohibit the concealment of fraud and corruption in accounts and financial records.[4]

The measures prescribed in UNCAC and the OECD Convention are designed to combat corruption *involving the private sector.* Classically, the key elements here have been bribery of state officials and agents *by the private sector*, along with related offenses by which public office is used for private gain. The latter might include, for example, collusion in public procurement and privatization transactions for purposes of illicit enrichment, trading in favors and influence, and "revolving door" practices by which officials are rewarded with corporate positions after they leave office. In contrast, UNCAC (arts.21-22) defines corruption *in the private sector* as including the giving and receipt of bribes by business people, as well as embezzlement, which may involve a fraud or abuse of fiduciary obligation whereby one person illicitly benefits at the expense of another. Further, UNCAC (arts.23-24) requires states to take effective measures against money laundering and other means by which acts of corruption are concealed, and to ensure that legal persons such as companies can be held liable for the corruption offenses described in the Convention (art.26). Thus, *corruption involving the private sector* has a relatively expansive definition, including public sector corruption in which the private sector participates as well as corruption within the private sector.

The preceding discussion should help clarify why UNCAC and the OECD Convention call for detailed rules and procedures for corporate governance and financial accountability in the private sector *as anti-corruption measures.* By extension, it should be clear why this Thematic Review appears to focus so little on bribery or undue influence *per se.* We are dealing here with necessary preventive and remedial measures to be taken by the private sector side, as stipulated in public laws and regulations as well as in codes developed by the relevant business and professional communities. The corporate governance and financial accountability provisions discussed here are expressly required by UNCAC and the OECD Convention, as part of member states' overall obligations to take effective measures for the prevention and detection of corruption involving the private sector.

Both UNCAC and the OECD Convention have evolved since their adoption, reflecting the implementation guidance provided by organizations such as the UN and OECD, as well as best practice around the world. A major advance in best practice came in 2002 with the United States' (US) adoption of the Sarbanes-Oxley Act of 2002. This was a response to a spate of major corporate fraud scandals, in which elaborate accounting manipulations played a leading role. Key components of the Sarbanes-Oxley legislation include independent oversight of public company external audits; strengthened rules on audit committees and corporate governance; enhanced transparency, executive accountability, and investor protection; and safeguards of external auditor independence.[5] (A more detailed summary is provided in Annex 2 below). Several of these provisions are reflected in international codes and standards,[6] and are cited in the tables of international standards below. Among others, Japan and the People's Republic of China ("P.R. China") adopted quite similar rules. The relevant provisions of Japan's Financial Instruments and Exchange Act and P.R. China's Basic Standard for Enterprise Internal Control went into effect in 2008. Hong Kong, China also implements best-practice standards in this area through modules of the Hong Kong Monetary Authority's Supervisory Policy Manual, the Securities and Futures Commission's Code of Conduct, and the Office of the Commissioner of Insurance's guidance notes. (See the relevant country reports.)[7]

The present Thematic Review deals with measures against corruption involving the private sector, as described above. The review is, however, somewhat selective rather than comprehensive. The main components of financial reporting, audit (internal and external), internal control, and related features of corporate governance are covered. We also deal with the efforts of the public and private sector to put appropriate measures in place, and to disseminate them, especially where there are joint efforts or mutual influence. In the interest of manageability, the review leaves out some important aspects of corruption control as it affects the private sector, deferring those topics to later studies. Thus, we set aside the issues addressed in UNCAC 12(2)(c-e), namely disclosure of beneficial owners, abuse of state policies (e.g. licensing) with respect to the private sector, and “revolving door” issues involving former state officials. We also deal in only a limited way with whistle-blowing, a large and complex topic. These areas would be worth at least one, and perhaps several, separate studies.

This review covers all 31 member countries of the Initiative. As with prior reviews, this one strives to be as comprehensive, accurate, and nuanced as possible – but the scale of the undertaking precludes a very detailed analysis of each country. A further complication arises from constraints to information. Current materials are not available in English for all the countries and all the matters covered. In order to obtain as much useful information as possible, the Secretariat sent detailed questionnaires to government officials in all of the member countries, and asked them to forward additional questionnaires to businesses and accounting professionals. We received responses from about half the member countries, of which most were reasonably complete, and several included laws and regulations or links to them. We used this material and also carried out research on each country, primarily by internet search. Government websites, research databases, and international standards bodies were particularly helpful, although material available in this way (especially in translation) is not always kept fully up to date.

Using these methods, we compiled 31 country studies, each of which has been shared with the relevant member country for purposes of comment, correction, and adding information. Each country report contains the same thematic sections and tables (with country-specific columns added) presented in the horizontal report presented in Part 1 below. In addition, each country report contains an introduction with background material setting the context for the review of measures on private sector corruption, and each contains a conclusion with country-specific recommendations.

NOTES

[1] *United Nations Convention against Corruption,* UN Office on Drugs and Crime, 2004.

[2] *Convention on Combating Bribery of Foreign Public Officials in International Business Transactions*, OECD 1997, in OECD (2011), *Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and Related Documents.*

[3] *Recommendation of the Council for Further Combating Bribery of Foreign Public Officials in International Business Transactions*, OECD 2009 ("OECD Recommendation"), in *Id.*

[4] Additional excerpts of relevant portions of UNCAC and the OECD Convention and Recommendation are provided in Annex 1.

[5] Ernst & Young (2012), *The Sarbanes-Oxley Act at 10: Enhancing the reliability of financial reporting and audit quality.*

[6] For example, the APEC Anti-Corruption Code of Conduct for Business, Asia-Pacific Economic Cooperation, 2007.

[7] The OECD has undertaken significant work in in this area, notably the reports by the Asian Roundtable on Corporate Governance. Several of these are cited in the individual country reports below. Also see the report *Public Enforcement and Corporate Governance in Asia: guidance and good practices*, http://www.oecd.org/daf/ca/Public-Enforcement-Corporate-Governance-Asia.pdf. Further, the OECD Principles are in the process of revision, with completion expected in the first half of 2015.

Part I – Overview of Corporate Measures to Prevent and Detect Corruption in Asia-Pacific

1. Introduction

This report provides an overview of the key issues and findings of this Thematic Review. It is structured as follows. The next section addresses public-private cooperation and related efforts to raise awareness and standards with respect to private sector corruption prevention. Section 3 addresses the overall topic of internal controls, comprised of internal audit, the audit committee, and the other rules and procedures providing for internal control and compliance. Section 4 deals with several topics under the heading of financial accountability. These include financial record-keeping, financial reporting, external auditing, and auditor duties with respect to disclosing certain offenses. The part also addresses the standards and governance mechanisms for the accounting and audit profession, as well as the means by which the rules and standards in this area are enforced. Section 5 concludes with a consideration of findings and patterns that have region-wide implications.

2. General efforts to prevent corruption involving the private sector

We begin with a review of member country practices in the area of outreach by government and cooperation with the private sector. General efforts along these lines to strengthen the prevention and detection of business-related corruption can be categorized as follows: (i) legal or policy steps to encourage members of the private sector to self-report corruption offenses or to institute effective measures to prevent them; (ii) public-private efforts to strengthen, and increase awareness of, relevant standards and methods in this area; and (iii) the use of integrity pacts, by which the business community and others collectively monitor compliance with voluntary anti-corruption standards. The relevant international standards, based on the UN and OECD Conventions as well as best practice guidance, are provided in the table below.

The first approach uses the instruments of criminal law and procedure to provide incentives for companies to self-report corruption offenses or to ensure that they have effective systems of prevention in place. As in the practice of plea-bargaining used in certain legal systems (notably in the US), the self-reporting of an offense before it is discovered is considered as a possible mitigating factor in criminal prosecution and sentencing. This practice is sometimes formalized in the law, but as often is implicit in prosecutorial and regulatory discretion. In either case, the *scope* of mitigation generally remains under the discretion of the administrative agency or law enforcement body, allowing for the necessary tailoring of remedies to each situation.

A step beyond this is to provide legal/regulatory incentives encouraging companies to adopt stronger internal control systems. For example, in the US, having an effective compliance system in place before the commission of an offense is a mitigating factor in sentencing (notably under the Foreign Corrupt Practices Act of 1977 – see below). This has contributed to the widespread adoption of compliance programs by publicly traded companies. In Italy, a legislative decree recognizes as a criminal law defense a company's adoption of an effective "organizational model" to ensure compliance with legal norms including laws against corporate bribery. The Italian Ministry of Justice has the authority under the decree to approve corporate guidelines and codes of conduct drawn up by business associations, and works proactively in assisting companies to establish corporate compliance measures in accord with the approved models. The latter include provisions that prohibit illicit payments to foreign officials (directly or through intermediaries) and recommend reporting, control, and sanction mechanisms.[1] Similarly, the United Kingdom's Bribery Act penalizes commercial organizations that fail to establish adequate procedures to prevent bribery. By implication, having an effective compliance program appears to be a defense against prosecution.[2]

Cooperative public-private initiatives provide further alternatives. Outreach programs by government agencies and joint state-private initiatives are of long standing, and were common practice in such areas as health and agriculture before being applied to corruption and corporate governance. Leading innovators in this area include anti-corruption agencies (ACAs) in at least two of the Initiative member countries – Australia and Hong Kong, China.[3] In addition to training and awareness-raising, efforts in this area sometimes take the form of agreements by public and private sector entities to work jointly to improve corporate governance and corruption prevention in the private sector. In France, for example, the Central Department for Corruption Prevention, under the supervision of the Ministry of Justice, has entered into partnership agreements with large companies to strengthen prevention, notably in the arms, construction, and hotel industries. In addition, the government has, working through the largest national business association, actively encouraged French enterprises to set up internal control mechanisms for detecting bribery.[4]

Cooperation within the public or private sector can also play an important role. This is perhaps most obvious with regard to cooperation between government departments such as the securities regulator and law enforcement actors such as prosecutors. Cooperation within the private sector may also be important in promoting collective action against corrupt practices in business. A leading example of this is the integrity pact, a method brought to global prominence by Transparency International. The method requires participants (in this case, companies) to make a public pledge to support and comply with certain integrity standards (e.g. prohibition of corporate bribery). The private sector, often with support from non-governmental watchdog groups, monitors the compliance of pact members. This may involve periodic reviews, reports, and/or audits. A leading global example of this method is the Extractive Industries Transparency Initiative (EITI), in which several Initiative member countries are participants. The EITI differs from the private sector initiatives described above in that governments are the main signatories, but the mechanism is essentially the same.

***International standards:* general prevention efforts**
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses.[5] 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.[6]
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.[7]
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.[8]

Member country compliance

In several member countries of the Initiative, there are only limited efforts by government, the private sector, or local civic organizations to address corruption involving business. Where there are anti-corruption efforts involving some or all of these sectors, they most often focus on bringing transparency and reform to the public sector, placing little emphasis on prevention from the private sector side. A number of member countries do have anti-corruption initiatives that span the public and private sectors, some of them also involving NGOs. Again, the emphasis is largely on the public sector, but in some of these cases the private sector dimension is given significant focus (see the box below). Indonesia and Hong Kong, China, for example, have frameworks of public-private cooperation to support corruption prevention, whistle-blowing, and related matters in the business sector. In other cases, anti-corruption efforts are principally led by the donor agencies (Afghanistan), the government (Cambodia, Malaysia, P.R. China, Sri Lanka), or by the NGOs (Bangladesh, Nepal).

Member countries with anti-corruption initiatives involving significant public-private cooperation:

Australia – Hong Kong, China – India – Indonesia – Japan –Kazakhstan – Korea – Kyrgyz Republic – Macao, China – Mongolia – Philippines – Singapore – Solomon Islands – Thailand – Timor-Leste

Virtually all member countries provide some channel for complaints and reports on corruption, and many countries provide multiple channels. These channels are designed to receive whistle-blower reports from within companies or government institutions. Most countries do not have formal arrangements to encourage self-reporting or preventive measures against corruption by companies, such as reduction of penalties or sentences in cases of prosecution. However, a substantial minority of member countries (see below) report that these factors are, in practice, taken into account in sentencing.

Member countries that consider self-reporting and preventive measures in enforcing sanctions against corruption:

Australia – Hong Kong, China – India – Japan – Kazakhstan – Korea – Macao, China – Malaysia (for witnesses) – Mongolia – Nepal – Singapore – Sri Lanka – Viet Nam

Virtually every member state reports having some form of outreach or cooperation between the public and private sector on corruption prevention. In most cases, the activities, such as awareness-raising and training seminars, touch on private sector concerns – though to varying degrees. Typically, the lead anti-corruption agency takes the initiative in providing guidance and organizing events, with the cooperation of civic, business, and/or professional organizations. In some cases, the private sector or the accounting profession plays the lead role, as reported in Bangladesh. In other cases, the main government role is taken on by economic policymakers or financial regulators, as in Japan and the Cook Islands. In some cases, government enters an agreement with the private sector to support and monitor anti-corruption efforts, as in Cambodia's MOU with a leading multinational company.

Most countries also have corporate governance standards that are developed by government, private sector associations, professional bodies, or a combination. Usually, the securities regulator or stock exchange issues the main corporate governance standards. In other cases, as in India, Kazakhstan, Nepal, and P.R. China, chambers of commerce or other business or sector associations take the lead. Further, anti-corruption agencies sometimes contribute significantly to the setting of corporate governance standards, particularly with respect to prevention of bribery – as in Fiji Islands; Hong Kong, China; Macao, China; and Singapore.

Integrity pacts are less frequently used. Several member countries belong to the EITI, which uses an international mechanism that incorporates the features of an integrity pact. They include Australia, Kazakhstan, the Kyrgyz Republic, the Solomon Islands, and Timor-Leste. Other sector-specific pacts deal with procurement (in India, Korea, Malaysia) or construction (in Viet Nam). Thailand and Hong Kong, China create a similar framework of incentives by providing public awards for good corporate governance (in addition to imposing sanctions on unethical contractors). Korea has amended its laws on public procurement (national and local) so as to require all bidders to sign integrity pacts.

3. Internal controls

Under the rubric of *internal controls*, this review considers three major features of corporate governance systems. These features aim to ensure that companies are operating efficiently, keeping proper accounts, complying with legal-regulatory norms and principles of good practice, and managing key risks. The internal control and compliance system, which we treat as one of the features, focuses exclusively on these goals. The other two features, internal audit and the audit committee (or equivalent body), play a central role in internal control but are also involved in the other main branch of corporate governance reviewed here – financial reporting. The relevant international standards are given in the tables below. Only one of these corporate governance features is addressed by name in UNCAC: "sufficient internal auditing controls" (art. 12(2)(f)). The other two features are central to good corporate governance practice (including the prevention of private sector corruption) and are addressed in guidance documents issued by the UN, the OECD, and others.

It is worth clarifying in what sense these three features of internal corporate control are *anti-corruption* measures. As explained previously, *corruption involving the private sector* includes bribery of public officials by businesses, as well as other forms of public corruption in which enterprises may be engaged, such as collusion with officials to engage in procurement or tax fraud. It also includes bribery among private enterprises, along with embezzlement and related forms of corporate fraud. Just as inspectors general and public auditors oversee government officials' compliance with legal and ethical rules of integrity in carrying out state functions, companies must ensure the proper conduct of their personnel. Thus, company internal auditors, general counsel, audit committees, and compliance officers monitor and verify adherence to applicable norms by corporate officers, managers, professionals, and other employees and agents. These norms include not only company policies and procedures but also the laws, regulations, and codes of conduct generally applicable to the company. Thus, an important dimension of corruption control is the internal governance of companies consistent with the external rules just mentioned. If companies and their executives face serious penalties for complicity in fraud or bribery, then internal control mechanisms that prevent such behavior take on critical importance for top management and the board of directors. In turn, governments and regulators have a corresponding duty to protect the public by requiring companies to maintain effective internal controls.

A. Internal audit

The internal audit function has evolved from a focus on accounting records to embrace a wider range of risk management, control, and governance processes. The internal auditor advises management with regard to all of the control systems that enable organizational objectives to be met. Internal audit is an assurance function that primarily provides an independent and objective opinion on the degree to which the internal control environment supports the achievement of organizational objectives. This function is necessary in companies with sufficient scale and differentiation that a founder or senior manager cannot gain this assurance through personal observation. This principal-agent problem, typical of state bureaucracies, arises as companies grow and become publicly owned. Thus, internal audit is usually not required for smaller and private companies. Indeed, legislative standards and uniform models for internal audit have not been the norm, at least until recently.[9]

The UN's guidance on implementation of UNCAC art. 12 states that member nations should apply laws and standards of corporate governance affording clear guidance and procedures on the core functions of internal audit in the private sector. The components of this (ranging from basic processes to more evolved processes for complex organizations) are as follows:

(i) a basic audit process reviewing the effectiveness with which assets are controlled, income is accounted for, and expenditure is recorded;
(ii) a system-based audit reviewing the effectiveness of financial, operational, and management control systems;
(iii) audits reviewing the legality of transactions and the safeguards against fraud and corruption; and
(iv) a full risk-management-based audit.[10]

The standards issued by the Institute of Internal Auditors (IIA) state that internal auditors have a professional duty to prevent and detect "illegal acts" in the books and records of companies. This suggests that they should seek to prevent and detect fraud and corruption, including bribery of foreign public officials (at least where such foreign bribery is a criminal offense). Internal auditors are also well positioned to encourage management and the board to combat fraud and corruption, given their close relationship with management and internal control. Internal auditors might also provide a safety-net for preventing, detecting, and reporting improprieties, including the bribery of foreign public officials, in companies that are not required to submit to an external audit. For companies that are also externally audited, the internal audit function provides the basis for an effective external audit.[11]

***International standards:* internal audit**
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).[12]
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect "illegal acts" in the books and records of companies, including bribery and other forms of corruption.[13]
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.[14]

Member country compliance

Internal audit appears to be practiced in all member countries, but not all of these countries impose it by means of a legal requirement or regulatory standard (see the box and graph below). In some countries where it is not required by law (e.g. Japan), there is nonetheless a longstanding practice of internal audit, which is considered a necessary feature of effective corporate governance and accountability. Such has often been the case in other leading economies as well. The requirement of internal audit in those countries is indirect or implied, since it would be difficult for a company to meet management goals, regulatory standards, or investor demands for accurate financial disclosure without an internal audit function. In several member states, internal audit is required by law, or at least strongly recommended by regulators or corporate governance codes, for listed companies and financial institutions (in many cases including insurers). Only Mongolia reports an internal audit requirement for all companies, although compliance appears to be difficult to achieve for most. Bhutan applies internal audit to companies controlled by the state holding company.

Member country internal audit provisions:

Internal audit required by law or advised by corporate governance code

For financial institutions: Afghanistan – Cambodia – P.R. China – Cook Islands – Fiji Islands – Hong Kong, China – Macao, China – Malaysia – Nepal – Philippines – Papua New Guinea – Thailand – Timor-Leste (per anti-money laundering law) – Vanuatu

For large or public interest entities (whether listed or not): Indonesia (public companies) – Japan (large companies) – Viet Nam (public interest entities)

For listed companies: Australia – Bangladesh – Cambodia – Fiji Islands – Hong Kong, China – India – Kazakhstan – Korea (large listed companies) – Malaysia – Pakistan – Singapore – Thailand

Professional standards (IIA or domestic)

Australia – Cambodia – P.R. China – Hong Kong, China (recommended) – India – Indonesia – Japan – Malaysia (voluntary) – Pakistan – Philippines – Papua New Guinea – Singapore (recommended)

Review legal compliance or detect fraud/corruption

Australia – P.R. China – India – Japan – Pakistan – Philippines – Vanuatu – Viet Nam

Review internal controls

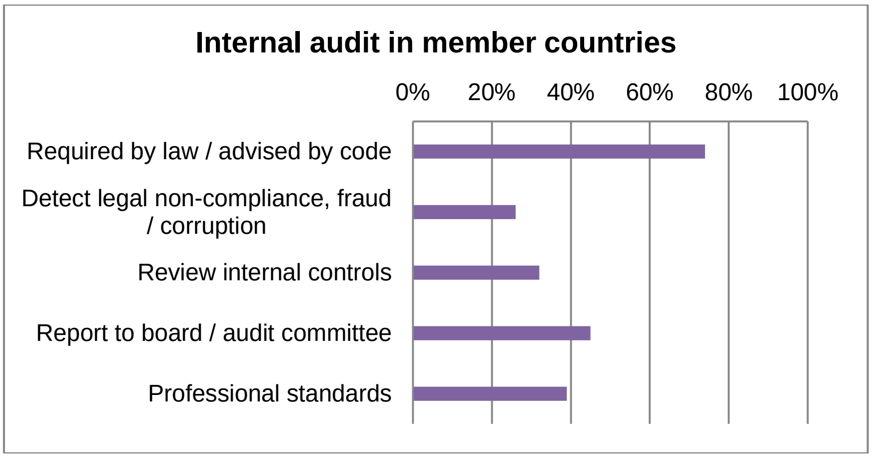
Australia – Cambodia – P.R. China – Cook Islands – India – Korea – Macao, China – Malaysia – Philippines – Vanuatu

Report exclusively to audit committee or board of directors

Australia – Bangladesh – Cambodia – P.R. China – Fiji Islands – India – Indonesia – Japan – Kazakhstan – Macao, China – Malaysia – Nepal – Philippines – Thailand

Often, there is no organized internal audit profession as such. However, practice standards for internal auditors are sometimes provided by a national chapter of the IIA or by internal auditors' membership in the licensed accountancy profession. In some of the countries, it is mandatory for internal auditors to meet professional standards (IIA or domestic standards), and in a few cases membership in a professional body is mandatory. In Japan and Korea, internal audit is performed in large companies by statutory or company auditors who have a mixture of audit-related functions. Only P.R. China reports having its own separate domestic institute on internal audit. Quality control of financial reporting and audit, as performed by professional bodies or regulators (e.g. in the banking and securities sectors), touches on internal audit. In a few cases such as Papua New Guinea, this oversight of internal audit is an explicit requirement.

Internal audit functions include basic oversight of accounting and financial reporting. Some systems also specify that the internal auditor must supervise internal controls more generally, often using risk-based criteria. A further function specified in some of the member countries (and in IIA standards) is to check the legal compliance of company operations. This in a few cases includes explicit mention of detecting fraud or corruption, or of money laundering (in the case of the Cook Islands). In order to serve as an effective check, internal audit must be independent of management functions. In several cases, a safeguard of independence is provided by requiring the internal audit function to report directly to the audit committee or board of directors. In the case of Vanuatu, the provision simply states that the internal audit function should be independent. In the case of Bangladesh, independence is emphasized by giving the internal auditors express authority to demand information or action by management. In other cases such as Pakistan and Singapore, internal auditors report jointly to the audit committee and to top management.



B. Audit committee

The OECD Anti-Bribery Recommendation (see the table below) advises the creation of monitoring bodies independent of management, such as audit committees (of the board of directors) or supervisory boards. The audit committee or an equivalent body is often designated to supervise the internal audit function, and should also be charged with overseeing the relationship with the external auditor, including any activities that hold the potential to create conflicts of interest (e.g. provision of non-audit services by the auditor to the company). The OECD also recommends that companies provide channels for persons to report breaches of the law or professional standards occurring within the company, including instances of undue pressure on employees or contractors to violate standards of professional ethics. Companies are encouraged to take appropriate action based on such reporting. These are functions that can, and frequently do, devolve upon the audit committee or similar body. Further, it is increasingly common for the audit committee to identify and recommend the external auditors to be retained for independent audits.

Observers stress the importance of the audit committee being fully independent of management. Thus, the Treadway Commission in the US proposed that any listed company should have an audit committee composed of non-executive directors. Globally, most stock exchanges require listed companies to have audit committees, and these are usually expected to include independent or non-executive directors, and in many cases persons with accounting or audit expertise. Over the last decade many jurisdictions, including most member countries of the Initiative, have adopted rules that increase the powers and duties of the audit committee, and require a charter that defines the committee's duties. Some countries, including the US and the UK, mandate an annual performance evaluation of the audit committee. [15]

The primary function of the audit committee is to assist the board in fulfilling its oversight responsibilities by reviewing audit processes (internal and external), internal controls, and all of the financial information to be disclosed. In carrying out this responsibility, the committee is usually expected to:

- provide open avenues of communication among internal auditors, the independent auditor, and the board of directors;
- report actions to the full board of directors and make appropriate recommendations;
- conduct or authorize investigations into matters within its scope of responsibilities, retaining independent counsel or accountants if necessary.

In the US, audit committees are often involved in assessing whether management has developed an effective compliance program to address corruption risk (under the Foreign Corrupt Practices Act).[16] Increasingly, audit committees in other countries have a similar role in checking compliance with anti-bribery legislation. The OECD's guidance (see the table below) incorporates these various functions.

***International standards:* audit committee**
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.[17]
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers, employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.[18]

Member country compliance

Virtually every member country requires the establishment of an audit committee or similar institution such as a supervisory board for certain types of companies – or at least recommends such a body in its corporate governance code. In the large majority of cases, the required body is an audit committee. Typically, audit committees are required for financial institutions, listed companies, and/or companies meeting a size threshold. For other companies, such bodies are often recommended – and often used. In some cases, such as Australia and Korea, only large listed companies are *required* to have audit committees, while other companies *may* establish committees as a matter of good corporate governance (and in Korea, audit committees are also required for financial institutions). In some of the countries, these bodies are required for public companies (Indonesia) or for state enterprises (Nepal, Samoa). Finally, in some cases, the law simply allows the establishment of board committees (Kazakhstan, Papua New Guinea (apart from the financial sector)) rather than requiring any specific body to be established.

A majority of the member countries specify the membership of the audit committee (or supervisory board). Typically, the committees must include independent (or outside) directors and persons with financial or accounting expertise. In two cases, some or all of the independent directors must be non-executive (Hong Kong, China and Vanuatu). Sri Lanka specifies either a majority of independent directors or at least two non-executive directors. Timor-Leste requires audit committees to exclude directors, shareholders, and employees. A few countries require members with financial literacy rather than accounting credentials (India) or do not expressly require members to have a finance background (Afghanistan, Bhutan, Indonesia, Vanuatu). Countries in which audit committee functions are handled by a board of auditors (Japan and Macao, China) require that board to be comprised of professional auditors or an audit firm.

Member country provisions on audit committee (or supervisory board) role in addressing irregularities, fraud, corruption:

Offer preventive guidance or take action:

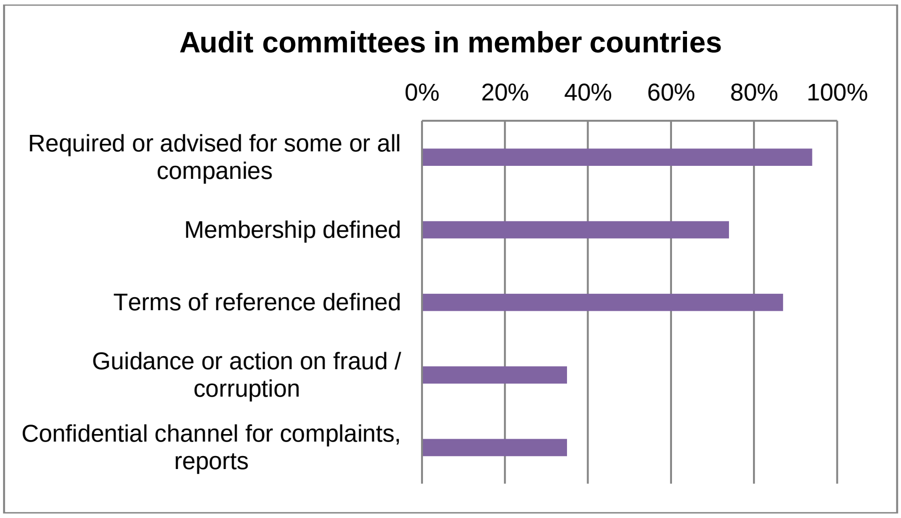
Australia (corruption) – Bangladesh (fraud: report to regulator) – Bhutan (fraud: report to regulator) – Fiji Islands (corruption: prohibit in ethics code) – Japan (order to cease) – Macao, China – Malaysia – Pakistan – P.R. China – Singapore – Viet Nam

Confidential channel for complaints and reports:

Australia – Fiji Islands (corruption) – Hong Kong, China – India – Macao, China – Malaysia – Pakistan – Philippines – Singapore – Sri Lanka – Thailand

The provisions may be legal requirements or recommendations for companies having such committees or boards. In other countries, fiduciary obligations or whistle-blower provisions may create an equivalent company responsibility.

Nearly all the countries define the audit committee's terms of reference to some extent, including the basic functions of supervising the accounting and auditing functions, and participating in the hiring of external auditors. In most countries, the committee terms of reference make specific mention of its role in oversight of internal controls, which often includes monitoring compliance with laws and company codes. A minority of member states (about one-third) explicitly require audit committees (or supervisory boards) to provide guidance or to take action with respect to problems of integrity and corporate governance. A similar number specify a responsibility for the committee to provide a confidential channel for complaints and whistle-blowers (see the box above and the graph below). Among all of these cases, only standards in Australia and Fiji Islands expressly mention corruption as a key concern of the audit committee, while those of Bangladesh and Bhutan mention fraud. Others use more general language to refer to non-compliance or irregularities.



C. Internal control and compliance systems

An important function of the board of directors is to oversee the internal control systems covering financial reporting and the use of corporate assets, and to guard against abusive related-party transactions. These functions are sometimes assigned to the internal auditor, who should report on these matters directly to the board or to the audit committee on the board's behalf. Where other corporate officers are responsible such as the general counsel or compliance officer, it is important that they maintain similar reporting relationships. In fulfilling its control oversight responsibilities it is important for the board to encourage the reporting of unethical or unlawful behavior without fear of retribution. Having a company code of ethics aids this process, which should be underpinned by legal protection for the individuals concerned. Often, either the audit committee or an ethics committee is specified as the contact point for employees who wish to report such concerns, or other matters that may compromise the integrity of financial statements. Companies are also advised to set up internal programs and procedures to promote compliance with applicable laws, regulations, and standards, including criminal laws on corruption. Compliance must also relate to other laws and regulations such as those covering securities, competition, and work and safety conditions.[19]

Internal control has several components. These vary somewhat between sectors and countries, and are also evolving over time as companies and standard-setting bodies address new challenges. According to the standard-setting body COSO,[20] there are five main components of internal control:

1. The *control environment*, which sets the tone of an organization, influencing the control consciousness of its people. The factors here include the integrity, ethical values, and competence of the personnel; management's philosophy and operating style; the way management assigns authority and responsibility, and organizes and develops its people; and the attention and direction provided by the board of directors.

2. *Risk assessment*, i.e. the identification and analysis of risks relevant to the achievement of corporate objectives. This provides the basis for determining how the risks should be managed, and should include mechanisms to identify and deal with the special risks associated with change.

3. *Control activities*: the policies and procedures that help ensure management directives are carried out and that necessary actions are taken to address risks to achievement of the entity's objectives. Control activities include approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets, and segregation of duties.

4. *Information and communication*—Information systems are needed to produce reports containing operational, financial and compliance-related information that make it possible to run and control the business. They deal not only with internally generated data, but also information about external events, activities and conditions necessary for informed business decision-making and external reporting.

5. *Monitoring* of the internal control systems, including assessment of the quality of the system's performance over time. This is accomplished through ongoing monitoring activities, separate evaluations or a combination of the two.[21]

The core internal control function common to all systems is that of *financial* control. Depending on the size of the organization and transaction, the financial controls could include, for example:

- separation of duties, so that the same person cannot both initiate and approve a payment;
- ensuring that a payee's appointment and work or services carried out have been approved by the organization's relevant approval mechanisms;
- requiring at least two signatures and supporting documentation for payment approvals;
- restricting the use of cash;
- ensuring that payment categorizations and descriptions in the accounts are accurate and clear;
- periodic management review of significant financial transactions.[22]

Increased global concern about fraud and corruption has led to adjustments in the approach to internal control. Thus, in the US, the Sarbanes-Oxley Act introduced the requirement of including an internal control report in every issuer's annual report, according to rules adopted by the Securities and Exchange Commission (SEC). The report must state management's responsibility for establishing and maintaining an adequate internal control structure and procedures for financial reporting, and provide an assessment of the effectiveness of that control system. In addition, an issuer's independent auditor must attest to, and report on, management's assessment, in accordance with accounting oversight standards. The assessment must be based on procedures sufficient both to evaluate design and to test operating effectiveness. Documentation and other evidence must be retained so as to provide reasonable support for management's assessment of internal controls. The assessment and report must address internal controls related to accounting and financial reporting, as well as controls related to the prevention, identification, and detection of fraud.[23] Japan and P.R. China have adopted parallel requirements in their legislation in this area (Japan's Financial Instruments and Exchange Act and P.R. China's Basic Standard for Enterprise Internal Control, see the relevant country reports).

In addition to addressing fraud, internal controls are increasingly concerned with bribery and other forms of corruption. An example of this is the US Foreign Corrupt Practices Act of 1977, which requires public companies to establish a system of internal accounting controls sufficient to provide reasonable assurance that:

- transactions are executed in accordance with management's authorization;

- transactions are recorded as necessary to permit preparation of financial statements in conformity with accounting standards and to maintain accountability for assets;
- access to assets is permitted only in accordance with management's authorization; and
- the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.[24]

In similar fashion, the UK Bribery Act, 2010 (sec.7) imposes duties to prevent bribery on a wide range of commercial organizations with ties to Britain – thereby ensuring that companies establish sufficient internal controls to prevent and detect corruption. Internal control provisions in this area are spelled out in some detail in the Guidance to the Act.[25] Among Initiative countries, Hong Kong, China appears to provide the most comprehensive standards on internal controls to combat fraud and bribery. These are set forth in the modules of the Hong Kong Monetary Authority's Supervisory Policy Manual and the Securities and Futures Commission's Code of Conduct (see the relevant country report).

In light of the adoption of UNCAC and the OECD Convention, business associations have developed guidance on compliance with these instruments. The International Chamber of Commerce, for example, issued recommendations on corruption prevention.[26] The approach to third-party agents and business partners is especially relevant to bribery concerns. The ICC advises, with respect to such third parties, that companies should instruct them neither to engage in nor to tolerate any act of corruption, and not to pay them more than an appropriate remuneration for their legitimate services. Contracts should empower the company to request an independent audit of the third party's books to verify compliance with the company's anti-corruption policies. Contracts should also include a provision allowing the company to suspend or terminate the relationship, if it has a good faith concern that a business partner has acted in violation of applicable anti-corruption law or company anti-corruption standards. The company should conduct appropriate due diligence on the reputation and the capacity of its business partners exposed to corruption risks to comply with anti-corruption law. The ICC provides a detailed framework for setting up an anti-corruption compliance program[27] (see Annex 2). Such guidelines illustrate the kinds of compliance programs that are likely to be effective. They may not be prescribed in detail by laws and regulations, but it is each company's responsibility to establish systems that ensure compliance with legal standards.

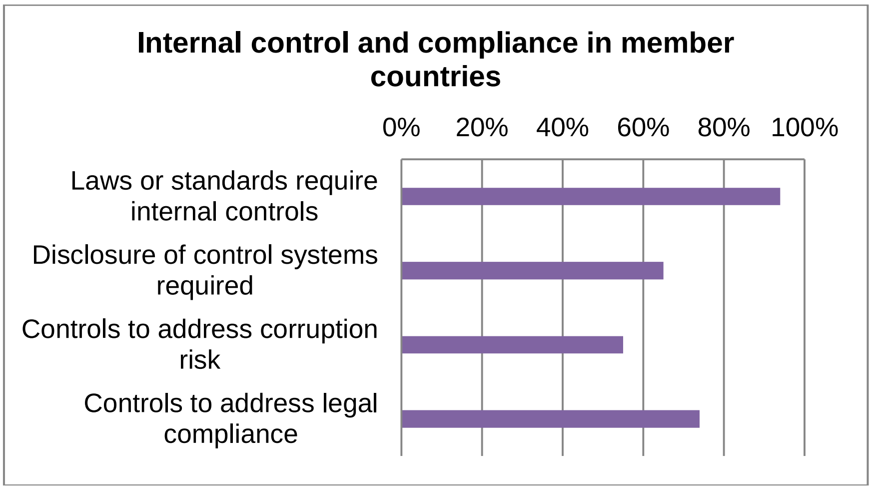
International standards: **internal control and compliance systems**
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation.[28] 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests.[29] 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees.[30] 4) Risk-based approach: • Individualized assessment of risks to the enterprise, including corruption risks. • Regular monitoring and re-assessment of corruption risks.[31]
Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements.[32] 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice.[33] 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations.[34] 4) Require for third-party representatives, consultants, or agents: • Written contract, adherence to company ethics standards and anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.[35]
Enforcement, including sanctions for failure to comply.

Member country compliance

A large majority of member countries have provisions on internal controls, whether legal-regulatory mandates or non-binding standards. Even beyond any explicit standards, internal control is often practiced as a matter of good corporate governance. As for standards, these are often articulated in codes of corporate governance and sometimes in regulatory instruments. In both of these approaches, regulatory authorities may use the standards as the basis for decisions related to licensing and compliance. In some of those cases, the standards may be enforced by means of fines or other penalties. Only in a few cases is internal control adopted as a requirement in general legislation (company law in India, accounting law in Kyrgyzstan) or identified as an element in fixing criminal liability for corporate offenses such as fraud (Bhutan and Hong Kong, China). The majority of rules and standards on internal control are applied to certain categories of companies only, such as financial institutions, listed companies, and large or public-interest entities.

The content of the internal control framework varies across the region (see the box and graph below). A majority of member countries encourage companies to disclose their internal control framework. This may be required or recommended, and in a few cases is mandatory regardless of whether internal controls themselves are required – i.e. a "comply or explain" rule. Where member countries have identified a corporate unit responsible for supervising internal control functions, this is most frequently the audit committee. A substantial minority of the countries require or recommend steps to demonstrate a commitment by management to company-wide compliance, such as designating a compliance officer, requiring training in this area for managers and/or staff, or adopting a corporate code of conduct. Most countries include compliance with laws and regulations as an element in the internal control standards. Also, a majority stipulate that internal controls should reflect assessment of operational and governance risk, with some of them calling for regular monitoring and/or periodic re-assessment. Lastly, over half of member countries identify corruption-related risks as key concerns of the internal control system. Some of these mention corruption explicitly, while others focus on fraud or money laundering, and a number of them deal with such corruption-related concerns as the giving of gifts and contributions (Fiji Islands; Hong Kong, China; India; Thailand) and/or retention of third-party agents (Bhutan; Fiji Islands; Hong Kong, China; India; Japan; Thailand).

Internal control provisions in laws, regulations, or codes of corporate governance	
Disclosure of internal controls	Australia – Bangladesh – Bhutan – Fiji Islands – Hong Kong, China – India – Japan – Korea – Macao, China – Malaysia – Mongolia – Nepal – Pakistan – Palau – P.R. China – Samoa – Singapore – Sri Lanka – Thailand – Vanuatu – Viet Nam
Internal controls address legal compliance <u>and</u> corruption risk	Australia – Bangladesh – Bhutan – Cambodia – Fiji Islands – Hong Kong, China – India – Indonesia – Japan – Malaysia – Palau – P.R. China – Thailand – Solomon Islands
• **legal compliance only**	Afghanistan – Kazakhstan – Pakistan – Philippines – Papua New Guinea – Sri Lanka – Timor-Leste – Vanuatu – Viet Nam
• **corruption risk only**	Korea – Macao, China – Mongolia



4. Integrity of financial statements

This part of the review addresses several topics relating to the financial disclosures of companies to external parties, as contrasted with the internal company control policies dealt with in Part 2. The two are closely related, since a central concern of internal control is the completeness and accuracy of the accounting information that enters the processes of preparation and independent auditing of financial statements. Here, we consider the issues of financial record-keeping, financial reporting, and external audit. The latter two fields are subject to detailed international standards. Further, we review the standards applicable to the accounting and auditing professionals charged with ensuring the accuracy of financial reports. Last, we examine the institutional mechanisms and sanctions for enforcement of the rules in this area.

Again, it may be worth clarifying in what sense the safeguards of accounting, financial reporting, and external audit are *anti-corruption* measures. The previous section focused on the mechanisms for ensuring *internal* compliance with company rules, public laws, regulations, etc. Those mechanisms are designed to enforce the accountability of company officers, employees, and agents to senior management and the board of directors. By contrast, the mechanisms dealing with the integrity of financial statements are expected to enforce the *external* accountability of the company to its owners, as well as to potential investors and thus the public at large. If a company's internal control systems fail to prevent or detect corruption, an additional check is provided by the external accountability mechanisms of financial reporting and independent audit. Just as public records and asset declarations afford the documentary basis for the accountability of government officials to the population, audited financial statements furnish the essential evidence by which companies are judged not only on their business success but on their integrity as well. The state helps to safeguard public welfare by ensuring that companies compile and disclose their financial information, and submit it to independent audit, according to the most exacting standards. If an enterprise is involved in corrupt activity, an effective system of accountability in this area will ensure either that evidence of such activity is disclosed or that the enterprise is held liable for concealing the activity.

A. Accounting

1. Financial records

Accurate financial reporting critically depends on the integrity of the accounting records and source documents used to generate the financial reports. Both UNCAC and the OECD Convention recognize the importance of preserving complete and accurate records for the prevention and detection of corruption (see the table below). Most jurisdictions address this issue by means of legislation on taxation, corporations, and/or securities, although occasionally record-keeping provisions are included in anti-corruption laws.[36] Record-keeping and accounting rules must contend with the multitude of ways in which bribes may be concealed in company accounts. Bribes have been mischaracterized, for example as commissions or royalties, consulting fees, sales and marketing expenses, and other legitimate cost items.[37] Other tactics include destroying records or keeping account of illegal transactions in a separate, concealed, set of books.

International standards: **financial records**
Record-keeping requirements: form, method, and minimum time period for retention of financial records.[38]
Prohibitions (UNCAC 12(3), OECD Convention 8(1), OECD Recommendation[39] X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.

Member country compliance:

The most common record-retention period in the region is a minimum of ten years, required by 13 countries (including Bangladesh, which requires 12 years). A further eight countries require at least seven years' retention (including India, requiring eight), and 12 countries require at least five years (including two that set a minimum of six). Most of these minimum periods apply to all companies, although in several cases they apply only to listed companies or financial institutions, or to certain records. In the latter cases, shorter retention periods apply in other circumstances. Where specified, the retention rule usually applies to all records and primary documents such as receipts. In Korea, the ten-year period applies to accounting records, and a five-year minimum to back-up documents; in Viet Nam, a ten-year period applies to audit records only.

Most of the member countries have a specific legal-regulatory prohibition against the falsification of financial records and documents and/or the use of such false documents.[40] Even in the absence of such an express prohibition, all or virtually all countries have an applicable prohibition in their general commercial or criminal laws. The specific rule in some cases applies to certain categories of firms such as listed companies or financial institutions, as in Bhutan and the Cook Islands. A majority of member countries also specifically prohibit the early or improper destruction of financial records and documents, although in all or nearly all countries the record retention rule can be applied so as to penalize such destruction.[41] In a few cases (e.g. Australia, Korea), the specific prohibition also extends to the alteration or damaging of the records.

A substantial minority of member countries have express prohibitions in place against certain record-keeping and accounting practices that may be used to disguise fraud and corruption (see the box below). Most of this latter group of countries penalize inaccurate or misleading entries[42] (i.e. records that are partially incorrect but shown to be deliberately falsified), while a few expressly prohibit unrecorded or concealed transactions, or the use of multiple sets of books.

Member countries expressly prohibiting practices that may conceal irregularities

Inaccurate or misleading entries:

Australia – Afghanistan – Bhutan – Cambodia – Cook Islands – India – Indonesia – Japan – Kazakhstan – Macao, China Malaysia – Mongolia – Philippines – P.R. China – Singapore – Sri Lanka – Thailand

Concealment or non-recording of transactions, multiple sets of books:

Japan – Macao, China – Philippines – P.R. China

In countries that have adopted International Financial Reporting Standards (see below), the above manipulations should be impermissible for all entities to which those standards apply. Also, a legal provision that does not expressly prohibit specific actions may be understood in practice to include such actions (e.g. concealment or non-recording in Australia).

2. Financial reporting requirements

In addition to the record-keeping and accounting measures mentioned above, UNCAC (art.12(2)(f)) and the OECD Anti-Bribery Recommendation (rec. X) require member states to maintain sufficient financial reporting and auditing controls to prevent and detect corruption. Those measures need to be robust enough to counteract the various subterfuges discussed in the section above. OECD Recommendation X (see the table below) further requires financial reporting standards to include the disclosure of all material contingent liabilities, including those related to bribery. The OECD comments that this is intended to ensure that companies, in order to meet this disclosure requirement, must take into account the full potential liabilities under the OECD Convention (arts.3, 8) including all losses that might flow from conviction of the company or its agents for bribery.[43] Best practice in this area generally means adoption of the International Financial Reporting Standards (IFRS), and their full application to companies whose size, sector, or ownership creates a need for public accountability.

The IFRS Conceptual Framework sets out basic qualitative characteristics for financial reports such as faithful representation, relevance, and materiality, along with enhanced characteristics that reporting systems should strive to achieve. The latter include comparability, verifiability, and timeliness. Thus, financial information must not only represent relevant phenomena, but it must also faithfully represent the phenomena that it purports to represent – i.e. it must be complete, neutral and free from error. International Accounting Standard (IAS)[44] 1.15 provides another critical characteristic: fair presentation. Financial statements must fairly present the financial position, financial performance and cash flows of an entity, while accurately representing the effects of its transactions. When IFRS are accurately applied, financial statements are presumed to give a fair presentation.[45] Thus, the use of false documents, off-the-books accounts, inaccurate recording of transactions, fictitious liabilities or expenditures, and disguising improper activities are all in principle impermissible under IFRS.

Further, IFRS prescribe the appropriate treatment of contingent liabilities such as those that may arise from illegal transactions. In principle, this would include the results of the company having engaged in bribery and other forms of corruption, such as prosecution, administrative sanctions, loss of future contracts or damage to the company’s reputation or competitive position as a result of corruption investigations. Thus, IAS 37 requires the disclosure of “material contingent liabilities,” even though they can be recognized as having financial effects for accounting purposes only in limited circumstances. The point of disclosure is to note the potential financial impact of the liability – “materiality” refers to this impact, but this is left to the judgment of professionals rather than fixed as a quantitative threshold.

Under IAS 37.86, an entity must disclose its contingent liabilities unless the possibility of any financial outflow in settlement of such liabilities is remote. The financial report must provide a brief description of the nature of the contingent liability and, where practicable:

- an estimate of its financial effect,
- an indication of the uncertainties relating to the amount or timing of any outflow, and
- the possibility of any reimbursement.

The IFRS also state that such contingent liabilities should be continually monitored, and if the outflow of resources becomes probable, they should be recognized as a more definite category of liability termed “provisions.”

The estimated losses due to an *actual* prosecution would have to be *disclosed and recognized* under IAS 37. But where there is only *potential* liability for future prosecution, and this possibility *is not deemed remote*, this would simply have to be disclosed in the financial statement notes without elaboration. In practice, this seems to mean the following:

- Prosecution for bribery would generally be deemed remote unless the bribery has somehow been revealed and investigations are underway or expected.
- Therefore, no material liability of this kind is likely to be disclosed unless the allegations are already public.
- However, once investigations are underway, the lack of any prior disclosure creates an additional opportunity for the prosecution: it can pursue the primary offense of bribery (domestic or foreign) or, if it has insufficient proof for a criminal conviction on this basis, it can pursue criminal and administrative penalties against the company for failure to disclose material contingent liabilities in financial reporting.

As a result, accounting professionals in IFRS jurisdictions are likely to conclude that *no liability need be either recognized or disclosed for potential future effects of a company’s having engaged in corruption*. The OECD notes that even relatively large payments to foreign public officials would not necessarily trigger the “materiality” threshold under IFRS 37, especially for large companies.[46]

The IFRS also require consolidated financial reporting[47] for certain related entities and transactions that might otherwise have been reported separately. The OECD points out that failures in corporate governance can often be linked to the failure to disclose the “whole picture,” particularly where off-balance sheet items are used to provide guarantees or similar commitments between related companies. This applies as well to the prevention and detection of corruption when the costs of bribes and other illegal transactions are obscured in this way. It is therefore important that transactions relating to an entire group of companies be disclosed in line with international standards.[48] Accordingly, under IFRS 10, a company that owns 50% or more of a subsidiary must include that subsidiary in its consolidated financial statement. The same applies to a special-purpose vehicle (SPV) over which the reporting company exercises control. The standards require a clear and fair presentation of such consolidated financial reports, which means, for example, that entries must be grouped into relevant categories and offsetting credits and debits must be cancelled out.

In implementing best practice standards, it is important to use the criterion of *proportionality*. As indicated above, the IFRS are mainly designed for publicly-accountable corporations, and are usually applied to certain categories of entities such as financial institutions and very large or publicly-owned companies. In recognition of this, the International Accounting Standards Board (IASB) issued a tailored version of IFRS for small and medium-sized enterprises (SMEs) (IFRS for SMEs). These are intended for use by entities that have no public accountability but that are required, or choose, to publish general purpose financial statements for external users. Essentially, an entity is considered to have public accountability if its debt or equity instruments are publicly traded, or if it is a financial institution or other entity that, as part of its primary business, holds and manages financial resources entrusted to it by clients.[49]

***International standards:* financial reporting requirements**
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.[50]
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery.[51] 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).[52]

Member country compliance

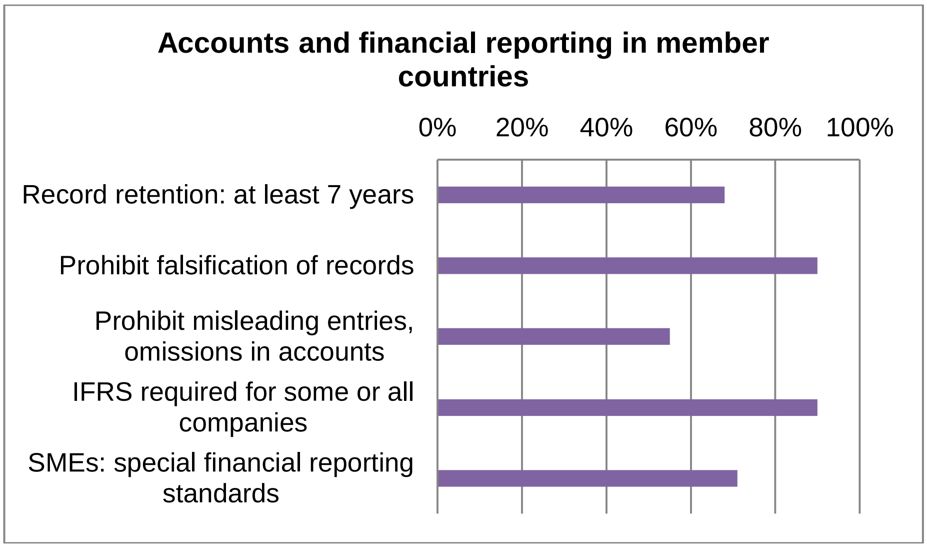
Nearly all member countries require the preparation of financial statements, and either currently mandate or are phasing in the use of some version of IFRS, by certain companies. Most commonly, all companies must prepare financial statements, although in some cases only companies that are publicly-owned, listed, or beyond a size threshold (Australia; Cook Islands;[53] Indonesia; Kazakhstan;[54] Korea; Macao, China; Pakistan; Vanuatu) are required to issue financial statements. As for the application (or phase-in) of IFRS, in a majority of countries, this is limited to financial institutions, large or listed companies, public-interest entities, and/or SOEs (Macao, China includes concessionaires as well). Most countries have a special arrangement for companies that need not meet IFRS or alternative standards applicable to companies that are large or publicly-accountable. In approximately half of these cases, the exempt companies are allowed to choose between local and international standards. In the remaining cases, the countries have adopted or are phasing in the IFRS for SMEs. (See the table and graph below.)

Member countries' scope of application or phase-in of IFRS

All companies	Large, public, or listed companies only	Financial institutions only	Special standards for SMEs*
Bhutan Hong Kong, China India Japan Mongolia Nepal P.R. China Singapore Solomon Islands Viet Nam	Australia Cook Islands[55] Bangladesh Cambodia Fiji Islands Indonesia Kazakhstan Korea Kyrgyzstan Macao, China Malaysia Pakistan Papua New Guinea Philippines Samoa Sri Lanka Thailand	Afghanistan Timor-Leste	Australia Bangladesh Bhutan Cambodia P.R. China Fiji Islands Hong Kong, China India Indonesia Japan Kazakhstan Korea Kyrgyz Republic Macao, China Malaysia Mongolia Nepal Pakistan Philippines Samoa Singapore Solomon Islands

*IFRS for SMEs or domestic generally-accepted accounting principles (GAAP).

The adoption of IFRS brings with it obligations in terms of reporting on specified categories of entities, transactions, and liabilities. The countries using full IFRS require the companies reporting under those standards to include affiliated companies, off-balance sheet transactions, and special-purpose entities in consolidated reports (as stipulated by IFRS 10). In a few countries, the requirement of a "true and fair" presentation of the financial state of affairs is not applied in specified circumstances, such as consolidated reporting for subsidiaries (e.g. in Fiji Islands) or for small businesses (e.g. in Hong Kong, China). This appears to be a concession to proportionality, but does not strictly comply with IFRS 10. Also, where IFRS (or even the older IAS) are applied, companies using these standards must report their material contingent liabilities (as required by IAS 37). That standard could be interpreted to include certain corruption-related matters such as the risk of prosecution for bribery or fraud. However, in nearly all cases, the possibility of prosecution is considered too remote to require disclosure as a contingent liability (see the discussion above).



B. External audit

1. Auditing requirements

As mentioned above, UNCAC and the OECD Convention require member states to maintain sufficient auditing controls to prevent and detect corruption. In this area, best international practice is embodied in the International Standards on Auditing (ISA).

In ISA jurisdictions, the external auditor is required to gain an understanding of the company's accounting policies and internal controls, and to assess the control risk environment. These steps are meant to enable the auditor to identify the types of potential material misstatements that could occur in the financial statements, and to design appropriate procedures to counteract the audit risks posed by potential misstatements. The external auditor should test the control systems by such means as inspecting documents supporting transactions and other events (as evidence that internal controls have operated properly), observing internal controls that leave no audit trail (e.g. who performs a given function in practice rather than on paper), and repeating internal control processes such as reconciliation of accounts.[56]

Further, audit reports must address risks of fraud or non-compliance with laws leading to material misstatements. These matters are contained in ISA 240 and 250 (see the next section, below). The external auditor is required to consider these risks in planning and performing the audit, although responsibility for detecting and preventing fraud and illegality lies with company management. With respect to legal compliance, the auditor cannot be expected to detect all illegalities, which must ultimately be determined by a court of law. The ISA clearly place overall responsibility on company management for providing accurate financial statements to the external auditor.

According to ISA 250, indicators of non-compliance with laws and regulations include the following:

- Payments for unspecified services or loans to consultants, related parties, employees or government employees.
- Sales commissions or agent's fees that appear excessive in relation to those ordinarily paid by the company, to industry practice, or to the services actually received.
- Purchasing at prices significantly above or below market price.
- Unusual payments in cash, purchases in the form of cashiers' checks payable to bearer or transfers to numbered bank accounts.
- Unusual transactions with companies registered in tax havens.
- Payments for goods or services made other than to the country from which the goods or services originated.
- An information system that fails, whether by design or by accident, to provide an adequate audit trail or sufficient evidence.
- Unauthorized transactions or improperly recorded transactions.

The external auditor should analyze the likely impact of failure to comply with laws and regulations, addressing such potential financial consequences as the imposition of fines, penalties, damages, threat of expropriation of assets, enforced discontinuation of operations, and litigation. The external auditor should consider whether such consequences require disclosure, or indeed are so serious as to call into question the fair presentation of the financial statements, or otherwise make the financial statements misleading.

Under the ISA, independent auditors are also advised to review due diligence on certain contractors and business partners of the client company. This relates to one of the key internal control issues discussed above, i.e. preventing the use of agents for bribery and other forms of corruption (domestic or foreign). ISA 402 provides guidance here. Contracts for services that are essentially mechanical (e.g. recording and processing client transactions) can be addressed by a company's own systems. But when the contractor actually executes the client's transactions and maintains accountability, the situation changes. Principal-agent risk is increased, thus requiring the company more carefully to examine the nature of the contractor's services, the terms of the agreement, the material financial statement assertions that are affected by the use of the contractor, and the contractor's financial strength and internal control systems.

International standards: **external audit requirements**
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.[57]
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.
Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks.[58] 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.[59]

Member country compliance

All member countries provide in some way for external audit. (Key audit provisions across the region are presented in the table at the end of the next section, below.) The large majority of member countries have adopted the ISA or a set of standards based on them, or are phasing in the ISA in some form. A few of the countries have no official audit standards but use or refer to the ISA in conducting external audits (Afghanistan, Bhutan, Cook Islands, Solomon Islands, Timor-Leste, Vanuatu). Ten countries require all companies to perform annual external audits. A further five countries impose a general requirement but exempt private companies or small businesses. The remaining countries require external audits of specified categories of companies such as large, listed, or publicly-owned companies; state enterprises; and/or financial institutions (Kazakhstan and Mongolia require audits of all joint stock companies).

In addition, many of the countries impose further requirements, usually on certain categories of companies. Large, listed, or public companies are in most cases required to publish their audited financials and/or to have external audits conducted by CPAs or regulator-approved auditors. Audited financials must in some cases be filed with the company registrar, financial regulator, or securities commission. (India appears to be the only country requiring *all* companies to conduct external audits and to publish their accounts.)

There is some variation in the region with respect to the stated obligations of the external auditor and the officers of the audited company in the conduct of the audit. In nearly all the countries, external audits in every case must include an opinion by the auditor as to whether the accounts are accurate or "true and fair" (Cambodia and the Philippines limit this requirement to large or listed companies[60]). This opinion usually is also required to address the process used in preparing accounts and financial statements, and in some cases to state whether all the necessary materials and cooperation were forthcoming. In 11 countries, the independent auditor must certify the opinion by means of a signature or signed statement. Half of the countries require the external audit to address internal control systems at least in certain cases (listed or large companies in Malaysia and the Philippines, financial institutions in the Cook Islands, Samoa (upon demand by the central bank), the Solomon Islands, and Timor-Leste). In eight countries, the external audit process must include some form of testing of the internal controls.

As for the companies' duties in the external audit process, the main ones are certification of the company accounts and full cooperation with the auditor. In virtually all cases, one or both of these duties is stipulated. In most cases, the signature or certification of the accounts is to be done by a director. In 13 countries, a corporate officer or manager must do so for at least certain companies, usually listed corporations or financial institutions (in the Philippines, large or listed companies and in Thailand, public companies). Eight countries include in the required signers the CEO and/or CFO. In two cases (Kyrgyzstan and Mongolia), having the CEO or CFO sign the accounts is reported to be the accepted practice but is not required by law. Nearly all countries have legal provisions requiring the companies (or the responsible officials) to afford the external auditor full cooperation and/or penalizing attempts to mislead or withhold information.

2. Auditor reporting of improprieties

As mentioned above, the ISA provide that an external auditor should pay special attention to possible fraud and legal non-compliance, and act accordingly. ISA 240 states these auditor objectives:

- To identify and assess the risks of material misstatement of the financial statements due to fraud;
- To obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and
- To respond appropriately to fraud or suspected fraud identified during the audit.

ISA 250 uses nearly identical language in stating the external auditor's duty to address legal compliance. Here, the focus is on compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements.

Each of these standards provides that the independent auditor should take up these matters (evidence of fraud or legal-regulatory violation) with management, and if appropriate, the audit committee/ supervisory board, board of directors, or other persons responsible for company governance. If the issues cannot be resolved at this level, the auditor should then consider the next steps. In the case of legal non-compliance, the external auditor may seek legal advice and/or qualify the audit report accordingly if management or the board is unresponsive or if sufficient information is not made available. The auditor should also consider whether there is a responsibility to report the identified or suspected non-compliance to authorities outside the company. In the case of suspected fraud, ISA 240 mentions the further option, where "the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit," of withdrawing from the audit assignment and obtaining certain written representations from the client company. In the latter case, the auditor should obtain a statement from the company that it is responsible for the design of internal controls to prevent and detect fraud, and that the company has disclosed its knowledge of possible fraud to the auditor. With regard to reporting to outside authorities, ISA 240 expressly acknowledges that the independent auditor's legal responsibilities (i.e. to report the fraud) may override the duty of confidentiality (to the client company) in some circumstances.

Two other considerations are relevant here. First, any duty to report fraud or illegality is limited by the provisions of ISA 240 and 250, and in practice, by the criterion of materiality – as is the case (see above) with disclosure of contingent liabilities in company financial reports. The usual practice is to consider these issues material if they have an impact on the accuracy of the financial statements, and especially if a hypothetical investor would be influenced by this in making an investment decision with respect to the company. As in the case of contingent liabilities, it may be possible for there to be a serious illegality (e.g. major bribery) without this necessarily having a material effect on the company's financial position.[61] By contrast, it is reasonably certain that a significant fraud would have such a material effect. Second, the auditor must decide if her/his legal duty to report a fraud (or serious illegality) overrides the duty of confidentiality. The latter is often dealt with by means of a legal-regulatory "safe harbor" clause that protects the auditor from liability for good faith exposure of irregularities. In some cases, general whistle-blower laws may provide this protection, and in others, the criminal law may impose an overriding duty on the auditor (and others) to report a crime.

International standards thus clearly support external reporting by the independent auditor,[62] yet some countries have encountered difficulty in achieving compliance. In the business community and the audit profession, it is widely agreed that a safe and conducive environment for investment depends crucially on the free flow of information, including candid exchange between companies and their external auditors. This raises the concern that imposing on the auditor a duty to report client irregularities externally may have a chilling effect, making companies more wary of their auditors – and auditors more wary of discovering (or acknowledging) evidence of improprieties. The OECD's reporting on this issue suggests that the matter remains unresolved in many of its member countries.[63] Yet, several Initiative member countries impose a duty of external reporting in some form (see below). This suggests that adjustments are possible and are indeed underway to achieve compliance with OECD Anti-Bribery Recommendation X.B.(v) – and that this can be done without unduly compromising the external audit process.

International standards: **external auditor reporting of improprieties**
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.[64]
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").[65]

Member country compliance

Nearly all member countries follow the ISA in some fashion, and nearly all of them recognize the duties contained in ISA 240 and 250 to report fraud, illegality, and serious or material irregularities. In all of these cases, the external auditor has a duty to report such matters to management and/or the board or its audit committee. Some of the countries have incorporated this requirement into their corporate or accounting-audit laws. Further, all member countries recognize that the auditor's duty to detect fraud or illegality includes the duty, where appropriate, to report these matters to external authorities. In nine of the countries, this potential duty is unlikely to be actualized, since there is neither a specific rule mandating the reporting of such matters to the regulatory authority, nor a safe harbor provision protecting the auditor from liability for such reports. It is possible in some of these countries that whistle-blower legislation would apply to such reports, or that general criminal or anti-corruption laws might create a duty to report, but this is not clearly established at this time.

In a majority of member countries, therefore, some basis exists for an external auditor to report improprieties to external authorities. Usually, banking or securities regulation mandates the reporting of such matters to the regulatory authority, and this is protected by a safe harbor clause. In some countries, the regulated institution itself must report within a stated period, and if it fails to do so, the independent auditor reports. Some of the provisions enable only the reporting of material irregularities or violations related to the regulatory standards (in Australia, any violation of the Corporations Act, including fraud). In contrast, it appears that only India, Hong Kong, China and Singapore provide comprehensively for reporting of these matters by auditors in any sector, while protecting auditors acting in good faith by means of an explicit safe harbor provision.

External audit-related requirements in member countries

	All companies	Large, public, or listed companies only	Financial institutions only
Annual external audit	Australia (small companies exempt) Bangladesh Bhutan Hong Kong, China India Malaysia Nepal Pakistan Philippines (micro exempt) P.R. China Singapore (SME exempt) Solomon Islands Sri Lanka Thailand Viet Nam	Cambodia Cook Islands Fiji Islands Indonesia Japan Kazakhstan (JSCs) Korea Kyrgyz Republic Macao, China Mongolia (JSCs[66]) Papua New Guinea Samoa Timor-Leste Vanuatu	Afghanistan Palau
Publish audited financials	Australia India Malaysia Pakistan	Hong Kong, China (public and guarantee companies) Japan Thailand	Afghanistan Bhutan Cambodia Nepal Papua New Guinea Samoa Solomon Islands Timor-Leste

External audit-related requirements in member countries (cont.)

	All companies	Large, public, or listed companies only	Financial institutions only
Assess or test internal controls	Australia Bhutan Hong Kong, China Singapore Sri Lanka	Japan Macao, China Malaysia Philippines P.R. China	Cook Islands Samoa Solomon Islands Thailand Timor-Leste
CEO/CFO to sign/certify	India Pakistan Viet Nam[67]	Australia Bangladesh Indonesia (board of control) Korea (officer) Kyrgyz Republic (in practice) Mongolia (in practice) Philippines Thailand (officer)	Nepal Solomon Islands (manager)
External auditor reporting to authorities: legal duty and/or safe harbor	Australia Hong Kong, China India Korea Malaysia[68] Singapore Thailand	Bhutan Kazakhstan Philippines Papua New Guinea P.R. China	Afghanistan Cook Islands Fiji Islands Japan Macao, China Nepal Palau Samoa Timor-Leste Vanuatu

C. Professional standards and independence

The quality of financial reporting and auditing depends critically on the availability of highly qualified professionals. This in turn is affected by the governance of the profession and the rules and ethics codes applicable to professional engagements. OECD guidance addresses this area, as do a variety of international standards bodies dealing with accounting, audit, and corporate governance. These include the International Federation of Accountants (IFAC) and the International Organization of Securities Commissions (IOSCO). Key standards for purposes of this review are given in the table below.

***International standards:* professional standards and independence**
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.[69]
Auditors: Professional standards and oversight of external auditors. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.[70]

Member country compliance

Some 22 member countries have accounting/audit professions and standards that are fully established. The remaining nine countries are in the process of building a domestic profession in this area, and have relied on foreign-trained professionals and external standards to date. The large majority of countries provide for appointment of external auditors in their company, audit, or banking laws, or in sector regulations. Frequently, appointment and removal are by the annual general meeting (AGM) of shareholders, sometimes with approval of the company registrar or a regulator (banking or securities).

As for avoiding potential conflicts of interest, just over half of the countries expressly provide for regular rotation of independent auditors and/or audit firms, the typical requirement being every three years, and sometimes five or more (see the box below and the graph at the end of section D). In some cases, short periods (e.g. two or three years) are provided for individual auditors or partners, and longer periods (e.g. five or seven years) for audit firms. Only seven of the member countries restrict the hiring by companies of their former auditors. Bangladesh appears to prohibit this altogether, while other countries impose a cooling-off period (e.g. one year in Korea, two in Australia, and three in Macao, China).[71] A majority of the countries restrict the external auditor's provision to the client of non-audit services such as accounting or financial management, and most also restrict auditor interests in the client company. In both areas, disclosure requirements are often applied (e.g. in Australia, compulsory notification of conflict of interest situations to the regulator).

Member countries requiring external auditor rotation (individual auditor or audit partner)
After 3 years: Bhutan – Cambodia – Indonesia – Mongolia – Nepal – Viet Nam
After 5 or more years: Australia – Hong Kong, China (7 years) – India – Japan – Malaysia – Pakistan – Philippines – P.R. China – Singapore – Sri Lanka – Thailand

Regarding the governance of the audit profession, all but a few member countries have their own professional audit body. A majority of the professional governing bodies have statutory powers or are supported by a ministry or government agency – and can thus act with some degree of independence from the profession (see the box below). The latter point becomes especially important in the areas of quality control and professional discipline. Bhutan is unusual in depending largely on Indian-qualified auditors (though this is changing), while also requiring all external auditors to be empaneled by its state audit authority.

Member countries with state agencies or statutory bodies overseeing the audit profession
Afghanistan – Australia – Bangladesh – Bhutan – Cambodia – India – Indonesia – Japan – Kazakhstan – Korea – Kyrgyz Republic – Macao, China – Malaysia – Mongolia – Philippines – Papua New Guinea – P.R. China – Samoa – Viet Nam

D. Enforcement

Laws, regulations, and standards are of little account if there are no means to enforce them. Standards are sometimes effectively policed without the intervention of judicial authorities, as in professional codes of conduct and corporate integrity pacts. In general, however, rules that constrain the behavior of companies and their personnel require the power of regulators and law enforcement to ensure compliance. Thus, UNCAC, the OECD Convention, and related guidance documents (see the table below) call for accounting and audit rules to be framed and used effectively to combat corruption. This outcome depends in large part on the availability and appropriate imposition of "effective, proportionate and dissuasive penalties."

Thus, for example, the US Securities and Exchange Act stipulates fines up to USD 25 million against companies for each violation of the law's accounting provisions. Individuals are subject to a fine of up to USD 5 million and imprisonment for up to 20 years. These increased penalties were introduced in 2002 as part of the Sarbanes-Oxley Act, and apply to a range of accounting offenses by public companies and related individuals, including attempts to disguise illegal payments. Under separate legislation, courts may impose significantly higher fines—up to twice the benefit that the defendant sought to obtain by making the corrupt payment.[72] Among member countries of the Initiative, Japan and Malaysia also have relatively strict sanctions provisions in this area.

Apart from the strictness of the penalties, a critical issue here is the extent of their application. To which categories of companies (e.g. listed, public, large, financial) and individuals (e.g. directors, managers, accountants, auditors) do they apply? The relevant international standards and guidance documents (see below) suggest that best practice would be to apply sanctions as widely as possible within the constraints of proportionality and capacity. Thus, the US legal provisions mentioned above apply to public companies, and in some cases to issuers only. Other sanctions are available for financial reporting and external audit violations under the jurisdiction of the various federal and state authorities. This arrangement could be considered appropriate in light of the nature of US corporate governance and capital markets, and the scope of federal legislative authority.

Elsewhere, the balance is generally quite different. While some Initiative member states are also federal in structure, the arrangement of jurisdictions differs. As important, the extent of stock market listing and public ownership is in most cases much more limited, and the prevalence of control by families or tightly-knit corporate groups much greater. In this context, the OECD expressed concern about the limited scope of fraudulent accounting penalties in its member countries. Those sanctions tend to apply only to the activities of listed companies and to exclude accountants and auditors working for those companies. It also appeared unclear in some cases whether companies themselves could be penalized for fraudulent accounting.[73] As mentioned above, this does not mean that the excluded companies and individuals are not subject to sanctions under other legislative authorities. But these sanctions – whether imposed by revenue authorities, company registrars, or others – are likely to be less certain and less severe.

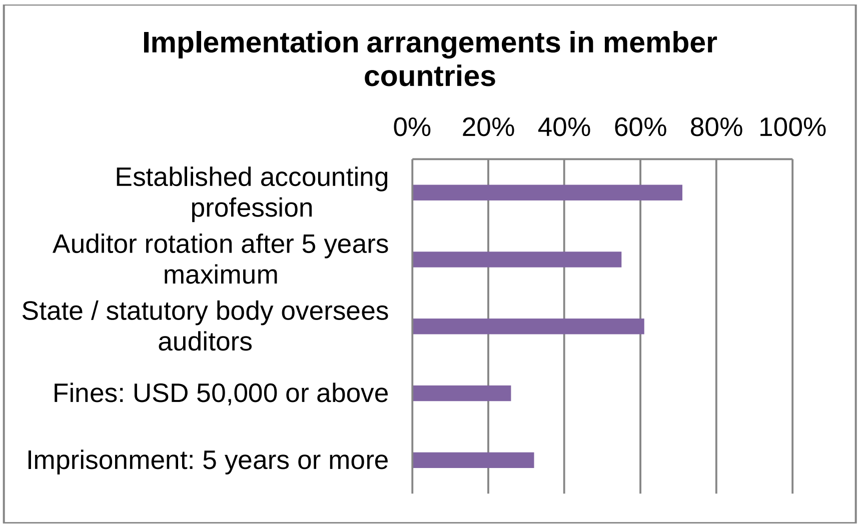
***International standards:* enforcement**
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1).[74] 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1) and 26, OECD Convention 8(1-2)):[75] 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards (UNCAC 12(1) and 26, OECD Convention 8(1-2)):[76] 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.

Member country compliance

Virtually all member countries have provisions in their laws and regulations stipulating offenses in the areas of accounting, financial reporting, and external audit, and fixing liability for penalties. Approximately half of the countries set maximum fines of USD 10,000 and above, including for intentional misstatements and frauds. The stiffest individual maximum penalties are those of Malaysia, which include fines up to USD 3 million and ten years' imprisonment. Japan, Papua New Guinea, and Singapore also provide prison sentences of up to ten years for the worst offenses.[77]

Member country maximum penalties for financial reporting-related offenses (individuals)
Fines USD 10,000 or above
Cook Islands – India – Palau – Samoa – Thailand – Timor-Leste – Vanuatu
Fines USD 50,000 or above
Cambodia – Macao, China – P.R. China – Singapore
Fines USD 100,000 or above
Hong Kong, China – Japan – Malaysia – Papua New Guinea
Imprisonment one year or more
Australia – Nepal – Pakistan – Vanuatu
Imprisonment five years or more
Cambodia – Hong Kong, China – India – Japan – Malaysia – Papua New Guinea – Samoa – Singapore – Sri Lanka – Thailand

Nearly all countries apply penalties to companies as well as individuals, although corporate penalties appear in most cases to be proportionally less strict than individual penalties. The application of these sanctions to the different categories of companies – e.g. according to size or public accountability – is determined by the scope of the legislation as indicated in the tables, above, on accounting and auditing rules. The majority of member countries limit the application of these rules and sanctions to large, public, listed, and/or financial sector companies. Most countries provide for sanctions against accounting and audit professionals for malpractice and fraud, including professional sanctions such as de-licensing, as well as administrative, civil, and criminal liability. The enforcement of penalties is reported to be either uncertain or less than strict in several of the member countries.[78]



5. Conclusion

A. General efforts to prevent corruption involving the private sector

The discussion above reveals that about half of member countries have anti-corruption initiatives involving significant public-private cooperation. About 40% consider such factors as self-reporting of corruption offenses or preventive measures as possible mitigating factors in criminal prosecution and sentencing. Most public-private initiatives do not actually focus on the private sector as the source or target of corruption. More of the member countries need to make this a key part of their anti-corruption efforts. Also, the use of alternative incentives such as awards for good corporate governance is at a very early stage in the region. This is an area that merits much more attention, resources, and experimentation. Last, integrity pacts are underutilized. Like other incentive-based approaches such as sentence-mitigation and award programs, and indeed like broader training and awareness-raising initiatives, integrity pacts have great potential to encourage compliance with governance standards but require only modest expenditure of state resources. Member states and particularly their business and NGO communities can and should make greater use of such mechanisms.

B. Internal controls

All member countries appear to practice corporate internal control of some kind, whether this is required by law or other instrument – or not. Of the three main components here (internal audit, audit committee, internal control systems), some are more commonly required by legislation than others (e.g. audit committee or supervisory board). All of the components appear to be practiced more widely than is strictly required by government policy, since they are normally considered part of good corporate governance – thus an expected (often implicit) feature of the bargain among company stakeholders.

A majority of member countries require internal audit for certain categories of companies (large, listed, and/or financial), and a substantial number of these require the internal audit function to report directly to the board or audit committee. As a result, nearly half of the countries have a rule in place that helps to safeguard the independence of the internal auditor. The remaining countries should follow suit by adopting appropriate provisions on independence and/or reporting of the internal audit function, whether by legislative instruments or voluntary codes. A minority of member countries specify internal auditor duties to detect and address corruption. A provision of this kind is needed in all the member countries.

The same is true for the audit committee – i.e. most (in this case, nearly all) countries require such a committee at least for some companies, but only a minority specify any duty of the audit committee to provide guidance on prevention or to receive and respond to reports on corruption. Most member countries need to do a better job of defining the committee's terms of reference clearly, and spelling out its anti-corruption functions. As for safeguarding the audit committee's independence, the record is also uneven. While independent directors are required among the membership in most cases, the criteria for independence are usually not clear – and the inclusion of accountants is often not specified. These issues need to be defined more precisely in most member countries.

As for internal control systems as a whole, these appear to be in place in all member countries, at least for publicly-accountable companies. Most of the countries also mention or specify internal controls in legislation or corporate governance codes. In most cases, provisions on internal control frameworks do not go beyond basic financial controls. It is important for all the member countries to ensure that corporate internal controls also deal with such matters as the "tone at the top," commitments to abide by internal codes of conduct, prohibition of corrupt practices, and clear standards on gifts, contributions, and the use of third-party agents.

Incorporating these components into legislation may not be the ideal approach in many countries at this time. Some of the countries that have addressed these matters have done so by means of corporate governance codes or regulatory instruments that enable an incentive-based approach. Here, regulators consider the companies' performance in official decisions on licenses, approvals, and good standing. A useful instrument here is a disclosure requirement, particularly the "comply or explain" approach. Government supervisors can check disclosure statements and perform risk-based audits and/or inspections to ensure accurate disclosure. These approaches offer practical ways to encourage effective internal control across all member countries – an important and necessary step on the way forward.

C. Integrity of financial statements

In this area, the spread of international standards is bringing improvements to the member countries, but those standards themselves have important limitations when it comes to addressing corruption. This is true of financial reporting and audit standards, but less so in other areas. With respect to accounting and record-keeping, the standards adopted by the UN and OECD set a high bar that few member countries appear to reach. Nearly all countries have clear retention periods and prohibit improper destruction and falsification of records. However, a range of other accounting manipulations including concealment and off-the-books transactions are in most countries not expressly illegal. Under the IFRS, these are impermissible practices. While most member countries are adopting IFRS in some fashion, those standards are not applicable to all companies. Further, treating those accounting manipulations as criminal offenses is likely to have more deterrent value than treating them as technical violations of financial reporting standards. The serious consequences of those practices need to be made clear across all member countries, and deterrent-level penalties established.

In addition, the adoption of IFRS brings with it such duties as consolidated reporting and disclosure of material contingent liabilities. Some member countries have delayed implementation of consolidated reporting, and in others the capacity to supervise such reporting is in question. On the matter of liabilities, the definition of the relevant standard (IAS 37) makes it unlikely that it can be used effectively as an anti-corruption tool. In both of these areas, member states are challenged to comply fully with the standards, and in the latter case to go beyond them in order to deter corruption. They need to meet this challenge.

In the external audit field as well, most member states are moving to international standards. Nearly all require the external auditor to render an opinion, and the company to cooperate actively with the auditor. Some of the countries require filing or publication of audited financials, CEO or CFO signature of the financial statements, and/or certification of the accounts by the independent auditor. These practices should be adopted as widely as possible in order to locate legal responsibilities and liability appropriately. This helps to make proper reporting and auditing incentive-compatible, as in the case (above) of internal controls.

Also in the external audit field, as in financial reporting, the standards have somewhat limited utility as anti-corruption tools. ISA 240 and 250 require the auditor to be vigilant about possible fraud and illegality, but (as in the case of IAS 37) stop short of requiring public disclosure. In this area, however, a majority of member states have gone beyond the standard in order to ensure disclosure. They have done so by requiring external auditors to report irregularities or non-compliance, or by providing a safe harbor clause to protect the auditor, or in a few cases both. These provisions in most cases apply to certain categories of publicly-accountable companies, as do the auditing requirements as a whole. These standards and provisions should be adopted across the member countries, and applied as widely as possible within the constraints of proportionality.

Effective implementation of the rules and standards discussed above depends upon professional capability and enforcement mechanisms. A clear majority of member countries have fully-established accounting-audit professions and governing bodies for the profession that are in principle independent. The countries without an established profession have relied on foreign-trained professionals, or have not been in a position to consolidate the profession and effectively govern it. The development of a domestic accounting-audit profession is a matter of capacity-building that will take time, and may not be appropriate for some of the smallest and most constrained member countries. On the other hand, the rules for appointment and independence of external auditors do not depend on these capacity factors. Most countries impose appropriate restrictions and procedures, although only a minority restrict the hiring by client companies of their former auditors. These standards need to be brought up to a high level of rigor in all member countries.

As for enforcement, the picture is less clear. All member countries have legal provisions of some kind stipulating penalties for financial reporting, auditing, and related corporate governance offenses. About one-third of these countries appear to have penalties (fines and imprisonment) that are potentially severe enough to provide a deterrent to individuals. Less clear is whether the penalties applicable to companies are sufficiently dissuasive, and whether the penalties are applied rigorously enough to secure compliance in practice. In at least half of the member countries, the most likely penalties to be used – i.e. fines – are far too low to provide the appropriate incentive. This is an area where most of the member countries need to bring their standards up to the level of those member states following best practice.

NOTES

[1] OECD (2006), *Mid-Term Study of Phase 2 Reports*, Working Group on Bribery in International Business Transactions, pp. 96-100.

[2] Ernst & Young (2010), *Building a Robust Anti-Corruption Program*, p.1.

[3] In Hong Kong, China, the Independent Commission Against Corruption with the support of six major commercial chambers set up the Hong Kong Ethics Development Centre. The Centre works with various private sector trades and professions to leverage their support for promotion of anti-corruption messages through websites, workshops, sharing sessions and feature articles, etc.

[4] OECD (2006: 96-100, *op.cit.*).

[5] UNODC (2012), *Implementation of article 12 of the United Nations Convention against Corruption, including the use of public-private partnerships*, CAC/COSP/WG.4/2012/2, p.10-12.

[6] OECD (2008), *Review of the OECD Instruments on Combating Bribery of Foreign Public Officials in International Business Transactions Ten Years after Adoption*, p.32-3; *Recommendation of the Council for Further Combating Bribery of Foreign Public Officials in International Business Transactions*, OECD 2009, ("OECD Recommendation") X(B)(iv).

[7] UNODC (2012): 10-12; OECD/ADB (2006), "Anti-Corruption Policies in Asia and the Pacific," ADB/OECD Anti-Corruption Initiative for Asia and the Pacific.

[8] UNODC (2012): 10-12.
[9] Pickett, K.S. (2003), *The Internal Auditing Handbook*, 2nd ed., Chichester: Wiley and Sons Ltd, pp.8, 74-79, 241.
[10] UNODC (2009), *Technical Guide to the United Nations Convention against Corruption*, pp.56-7.
[11] OECD (2008: 33-5) (*Review of the OECD Instruments…op.cit.*).
[12] *See* UNODC (2009), p.60, sec. II.9.
[13] Institute of Internal Auditors (IIA) standards.
[14] UNODC (2009): 56-7; *OECD Principles of Corporate Governance*, OECD 2004, pp.62-63.
[15] Pickett (2003: 9, 108); *The UK Corporate Governance Code*, Financial Reporting Council, 2012, (arts.B.6, C.3), https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-September-2012.pdf.
[16] Waweru, N., R. Kamau, E. Uliana (undated), "Audit Committees and Corporate Governance in a Developing Country, pp. 7-8, 12, http://ssrn.com/abstract=1147893; Deloitte, "Navigating Anti-corruption Compliance: Tools for Audit Committees," *Risk & Compliance Journal*, Oct. 15, 2013, http://deloitte.wsj.com/riskandcompliance/.
[17] OECD Recommendation X(C)(iv); US Sarbanes-Oxley Act (sec. 301, 407, and SEC Rule 10A-3).
[18] OECD Recommendation X (C)(v); *OECD Principles of Corporate Governance* (OECD 2004: 54-5, 62-3); US Sarbanes-Oxley Act (sec. 301).
[19] *OECD Principles of Corporate Governance* (OECD 2004: 62-63).
[20] The Committee of Sponsoring Organizations of the Treadway Commission.
[21] COSO (2013), *Internal Control — Integrated Framework*.
[22] BSI (2011), *Specification for an anti-bribery management system (ABMS)*. British Standard 10500: 2011.
[23] Cohen, A., Qaimmaqami, D. (2005), "The US Sarbanes-Oxley Act of 2002: Summary and update for non-US issuers," *International Journal of Disclosure and Governance,* 2.1: 81-106.
[24] Section 13(b)(2) of the Securities Exchange Act of 1934 (as amended by the FCPA).
[25] http://www.legislation.gov.uk/ukpga/2010/23/pdfs/ukpga_20100023_en.pdf; *The Bribery Act 2010: Guidance*, Ministry of Justice, 2011, pp.20-31.
[26] ICC (2011), *Rules on Combating Corruption*, ICC Commission on Corporate Responsibility and Anti-corruption, arts.2-5.
[27] ICC (2011), art. 10.
[28] OECD Recommendation X (C)(iii), OECD (2004): 53-4.
[29] OECD (2009), *Good Practice Guidance on Internal Controls, Ethics, and Compliance*, (A)(12). OECD (2004): 62; ISA 400; US Sarbanes-Oxley Act (sec.404).
[30] OECD (2009: (A)); International Chamber of Commerce (2011), *ICC Rules on Combating Corruption*, art.10.
[31] OECD (2009: (A)).
[32] OECD (2004): 62-3, ISA 240.
[33] OECD (2009: (A) 2).
[34] OECD (2009: (A) 5); ICC (2011): arts.4-5.
[35] OECD (2009: (A) 6); ICC (2011), art.3.
[36] The US FCPA, for example, in its "books and records" provision, requires issuers (entities that obtain financing through the issuance of securities) to make and keep

books, records, and accounts that, in reasonable detail, accurately and fairly reflect the entity's transactions and the dispositions of its assets.

[37] US Department of Justice and Securities and Exchange Commission (2012), *A Resource Guide to the US Foreign Corrupt Practices Act*, pp.38-39.

[38] UNODC (2009): p.57, sec. II.2. US Sarbanes-Oxley Act (sec. 210.2-06): seven-year retention period for audit work materials, e.g. all memos, correspondence, and email containing financial data or analysis.

[39] *Recommendation of the Council for Further Combating Bribery of Foreign Public Officials in International Business Transactions*, OECD 2009 ("OECD Recommendation").

[40] These offenses are usually defined as deliberate, thus distinguishing them from the compiling of records that are merely incorrect.

[41] The benefit of a rule expressly forbidding early or improper destruction is greater clarity as to the prohibited actions and penalties available, as well as the possibility of penalizing several related actions such as altering, damaging, or concealing records.

[42] This includes some countries (e.g. Australia, India, Singapore, and Sri Lanka) where the legislation is not explicit on this point but is reported to cover such practices.

[43] *Commentaries on the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions Adopted by the Negotiating Conference on 21 November 1997* in OECD (2011), "Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and Related Documents," p.17, Art.8.

[44] A set of standards incorporated into IFRS.

[45] *Source for IFRS provisions:* http://annualreporting.info/ifrs-standards/.

[46] OECD (2008: 21) (*Review of the OECD Instruments…op.cit.*).

[47] I.e., including disparate activities and entities in a single financial report, treating them essentially as a single business.

[48] OECD (2004: 50) (*Principles of Corporate Governance, op.cit.*).

[49] http://www.iasplus.com/en/standards/other/ifrs-for-smes.

[50] IFRS 10.

[51] OECD Recommendation X(A)(ii); OECD (2008): 21; OECD Commentaries art.8.

[52] Also OECD, *Commentaries on the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions*, *1997,* art. 8; OECD Recommendation X.

[53] State enterprises, international companies, and trust companies to submit annual returns.

[54] All joint stock companies.

[55] The public sector will transition to IFRS.

[56] ISA315 (revised) "Identifying and assessing the risks of material misstatement through understanding the entity and its environment;" ISA330 "Auditor's responses to assessed risks." These two provisions recently replaced ISA 400. *Source for provisions of ISA:* http://www.ifac.org/publications-resources/2013-handbook-international-quality-control-auditing-review-other-assurance-a. Comments by Price Waterhouse Thailand.

[57] OECD Recommendation X and X(B)(i), UNODC (2009): 56-7, sec. II.2, OECD (2008): 33-5.

[58] ISA 200.

[59] US Sarbanes-Oxley Act (sec.906).

[60] Hong Kong, China exempts SME audits from having to meet the "true and fair" standard.
[61] For example, where a company's violations of competition or procurement laws enhance its profitability while exposing it to only moderate risk of regulatory or criminal sanctions.
[62] OECD Recommendation X.B.(v).
[63] OECD (2008: 33-5).
[64] OECD Recommendation X(B)(iii); OECD (2008): 33-5.
[65] OECD Recommendation X(B)(v).
[66] Joint stock companies.
[67] A number of other countries such as Hong Kong, China require signature by the directors.
[68] Under general whistleblower legislation.
[69] OECD Recommendation X(B)(ii), OECD (2004): 54-5.
[70] OECD (2004): 54-5; IOSCO (2002), *Principles of Auditor Oversight*.
[71] Cambodia, Palau, and Sri Lanka also impose restrictions.
[72] US DOJ and SEC (2012: 68)**;** Sarbanes-Oxley Act of 2002, http://www.gpo.gov/fdsys/pkg/PLAW-107publ204/html/PLAW-107publ204.htm; 15 US Code § 78ff, http://www.law.cornell.edu/uscode/text/15/78ff.
[73] OECD (2008: 21).
[74] Also OECD Recommendation X.
[75] Also OECD Recommendation X(A)(iii); OECD (2008): 21, OECD (2006), "Mid-Term Study of Phase 2 Reports," p.91-2.
[76] Also OECD (2008): 21, OECD (2006): 91-2.
[77] Other penalties may apply to related offenses, such as improper disclosure of financial information by auditors or regulators.
[78] Australia applies a number of strict liability penalties in this area, but most of these are not very strict relative to other countries listed in the table below – e.g. in the area of holding directors and auditors liable.

Annex 1

Excerpts from UNCAC, OECD Convention, OECD Recommendation

UNCAC

Article 12. Private sector

1. Each State Party shall take measures, in accordance with the fundamental principles of its domestic law, to prevent corruption involving the private sector, enhance accounting and auditing standards in the private sector and, where appropriate, provide effective, proportionate and dissuasive civil, administrative or criminal penalties for failure to comply with such measures.

2. Measures to achieve these ends may include, inter alia:

   (a) Promoting cooperation between law enforcement agencies and relevant private entities;
   (b) Promoting the development of standards and procedures designed to safeguard the integrity of relevant private entities, including codes of conduct for the correct, honourable and proper performance of the activities of business and all relevant professions and the prevention of conflicts of interest, and for the promotion of the use of good commercial practices among businesses and in the contractual relations of businesses with the State;
   …..
   (f) Ensuring that private enterprises, taking into account their structure and size, have sufficient internal auditing controls to assist in preventing and detecting acts of corruption and that the accounts and required financial statements of such private enterprises are subject to appropriate auditing and certification procedures.

3. In order to prevent corruption, each State Party shall take such measures as may be necessary, in accordance with its domestic laws and regulations regarding the maintenance of books and records, financial statement disclosures and accounting and auditing standards, to prohibit the following acts carried out for the purpose of committing any of the offences established in accordance with this Convention:

   (a) The establishment of off-the-books accounts;
   (b) The making of off-the-books or inadequately identified transactions;

(c) The recording of non-existent expenditure;
(d) The entry of liabilities with incorrect identification of their objects;
(e) The use of false documents; and
(f) The intentional destruction of bookkeeping documents earlier than foreseen by the law.

…..

Article 21. Bribery in the private sector
Each State Party shall consider adopting such legislative and other measures as may be necessary to establish as criminal offences, when committed intentionally in the course of economic, financial or commercial activities:

(a) The promise, offering or giving, directly or indirectly, of an undue advantage to any person who directs or works, in any capacity, for a private sector entity, for the person himself or herself or for another person, in order that he or she, in breach of his or her duties, act or refrain from acting;
(b) The solicitation or acceptance, directly or indirectly, of an undue advantage by any person who directs or works, in any capacity, for a private sector entity, for the person himself or herself or for another person, in order that he or she, in breach of his or her duties, act or refrain from acting.

Article 22. Embezzlement of property in the private sector
Each State Party shall consider adopting such legislative and other measures as may be necessary to establish as a criminal offence, when committed intentionally in the course of economic, financial or commercial activities, embezzlement by a person who directs or works, in any capacity, in a private sector entity of any property, private funds or securities or any other thing of value entrusted to him or her by virtue of his or her position.

OECD Convention
Article 8
Accounting

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 foreign 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, records, accounts and financial statements of such companies.

OECD Recommendation

Accounting Requirements, External Audit, and Internal Controls, Ethics and Compliance

X. RECOMMENDS that Member countries take the steps necessary, taking into account where appropriate the individual circumstances of a company, including its size, type, legal structure and geographical and industrial sector of operation, so that laws, rules or practices with respect to accounting requirements, external audits, and internal controls, ethics and compliance 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, according to their jurisdictional and other basic legal principles.

A. Adequate accounting requirements
   (i) Member countries shall, in accordance with Article 8 of the OECD Anti-Bribery Convention, take such measures as may be necessary, within the framework of their 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 foreign public officials or of hiding such bribery;
   (ii) Member countries should require companies to disclose in their financial statements the full range of material contingent liabilities;
   (iii) Member countries shall, in accordance with Article 8 of the OECD Anti-Bribery Convention, provide effective, proportionate and dissuasive civil, administrative or criminal penalties for such omissions and falsifications in respect of the books, records, accounts and financial statements of such companies.

B. Independent external audit
   (i) Member countries should consider whether requirements on companies 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 external auditor who discovers indications of a suspected act of bribery of a foreign

public official to report this discovery to management and, as appropriate, to corporate monitoring bodies;

(iv) Member countries should encourage companies that receive reports of suspected acts of bribery of foreign public officials from an external auditor to actively and effectively respond to such reports;

(v) Member countries should consider requiring the external auditor to report suspected acts of bribery of foreign public officials to competent authorities independent of the company, such as law enforcement or regulatory authorities, and for those countries that permit such reporting, ensure that auditors making such reports reasonably and in good faith are protected from legal action.

C. Internal controls, ethics, and compliance

Member countries should encourage:

(i) companies to develop and adopt adequate internal controls, ethics and compliance programmes or measures for the purpose of preventing and detecting foreign bribery, taking into account the Good Practice Guidance on Internal Controls, Ethics, and Compliance, set forth in Annex II hereto, which is an integral part of this Recommendation;

(ii) business organisations and professional associations, where appropriate, in their efforts to encourage and assist companies, in particular small and medium size enterprises, in developing internal controls, ethics, and compliance programmes or measures for the purpose of preventing and detecting foreign bribery, taking into account the Good Practice Guidance on Internal Controls, Ethics, and Compliance, set forth in Annex II hereto;

(iii) company management to make statements in their annual reports or otherwise publicly disclose their internal controls, ethics and compliance programmes or measures, including those which contribute to preventing and detecting bribery;

(iv) the creation of monitoring bodies, independent of management, such as audit committees of boards of directors or of supervisory boards;

(v) companies to provide channels for communication by, and protection of, persons not willing to violate professional standards or ethics under instructions r pressure from hierarchical superiors, as well as for persons willing to report breaches of the law or professional standards or ethics occurring within the company in good faith and on reasonable grounds, and should encourage companies to take appropriate action based on such reporting.

Annex 2

Main Components of the US Sarbanes-Oxley Act of 2002:

Independent oversight of public company audits:

- Public Company Accounting Oversight Board established, with inspection, enforcement and standard-setting authority (ending self-regulation by the public company audit profession).

Strengthened rules on audit committees and corporate governance:

- Audit committees independent of management required for all listed companies, and made directly responsible (instead of management) for the appointment, compensation, and oversight of the external auditor.
- Companies required to disclose whether at least one "financial expert" is on the audit committee.

Enhanced transparency, executive accountability and investor protection:

- Audit firms required to disclose certain information about their operations (for the first time), including names of clients, fees and quality control procedures
- Chief executive officer (CEO) and chief financial officer (CFO) required to certify financial reports, and corporate officers and directors expressly prohibited from fraudulently misleading auditors.[1]
- Protection for whistleblowers employed by public companies who report accounting, auditing, and internal control irregularities.
- Management required to assess the effectiveness of internal controls over financial reporting, and auditors to attest to management's representations.

Safeguards of auditor independence:

- Audit firms prohibited from providing certain non-audit services to audited companies, and any non-audit services to be pre-approved by the audit committee.
- Mandatory rotation of lead audit partner every five years (formerly seven years).[2]

Annex 3

CC Corporate Anti-Corruption Compliance Program

Key components of such a program include: [3]

- a strong, explicit and visible support and commitment to the program by the board of directors and senior management ("tone at the top");
- a clearly articulated and visible policy binding for all directors, officers, employees, and third parties and applying to all controlled subsidiaries, foreign and domestic;
- periodic risk assessments and independent reviews of compliance by the board or relevant committee (e.g. audit committee), to include recommended corrective measures or policies, as necessary;
- placing responsibility on individuals at all levels of the company to comply with it policy and to participate in the corporate compliance program;
- appointment of one or more senior officers to oversee and coordinate the compliance program, with an adequate level of resources, authority and independence, reporting periodically to the board of directors or relevant committee;
- guidelines detailing appropriate behavior, prohibitions, and procedures required by the company's anti-corruption policy;
- periodic internal and external communication regarding the company's anti-corruption policy;
- providing to directors, officers, employees and business partners, as appropriate, guidance and documented training in identifying corruption risks in business dealings;
- including review of business ethics competencies in the appraisal and promotion of managers, and measuring the achievement of targets not only against financial indicators but also with respect to carrying out the company's anti-corruption policy;
- provision of confidential channels for personnel to raise concerns, seek advice, or report in good faith suspected violations without fear of retaliation or of discriminatory or disciplinary action.

NOTES

[1] Also included were "clawback" provisions for CEO and CFO pay after financial restatements.

[2] Ernst & Young (2012), The Sarbanes-Oxley Act at 10: Enhancing the reliability of financial reporting and audit quality.

[3] ICC (2011), art. 10.

Part II - Frameworks and Practices in 31 Jurisdictions[1]

NOTES

[1] India and Kazakhstan were unable to review and comment on their draft reports in time for this publication. Their reports will be added to the publication when finalized.

Afghanistan

1. Introduction

Afghanistan is building and remaking the institutions of government and the market in a context shaped by continuing conflict. The country's transition toward stable self-governance faces serious challenges from the protracted anti-government insurgency and from the elections and foreign troop withdrawals slated for this year. The international donors in 2012 pledged USD 16 billion in development aid through 2016 to help prevent the economy from collapsing and to promote stability. The donors have also called on the Afghan government to toughen its stance on corruption, so that the assistance can be used effectively. The Karzai government openly acknowledged that corruption is pervasive and intractable, and has indeed grown worse despite policy commitments such as the launching of the High Office of Oversight and Anti-Corruption. Similarly, the constitutional protection of free enterprise must contend with the reality that in several regions and sectors, security threats to businesses, the lack of a viable legal and regulatory framework, and corruption impede investment.[1]

Weak governance coupled with an economy shaped by instability and conflict creates a challenging business climate. The informal sector economy is estimated at about 80% of formal GDP. Opium production is growing (about a 60% increase in 2011) and returning to areas where it had been eradicated. The total value of opium production is approximately equivalent to 15% of the country's licit GDP. Illegality and self-dealing appear to thrive in businesses across the economy as a whole, putting Afghanistan in last place on the Protecting Investors indicator among the 183 countries surveyed in the 2011 IFC *Doing Business* study.[2] That indicator deals with preventing, and imposing accountability for, corporate insider self-dealing.

The most notorious example of the risks involved in this setting was the Kabul Bank crisis of 2010, from which the financial sector is still recovering. An estimated USD 850 million in fraudulent loans was diverted to insiders at state-owned Kabul Bank, representing 94 percent of the bank's outstanding loans. The board and senior managers were found to have been involved in a criminal scheme to fabricate loan documentation for fictitious companies, with the loan proceeds diverted to the bank officials for their personal use. The fraud triggered a bank run, resulting in reduced confidence in the banking system, depressing deposits and commercial loans. Audits of Afghanistan's major banks indicate systemic fragility and vulnerability in all areas of banking governance and operations, including skills, internal controls, accounting, credit analysis and compliance with regulations. In this difficult context, Kabul Bank was to be one of 56 SOEs to be divested through privatization, liquidation, corporatization or other mechanisms.[3]

2. General efforts to prevent corruption involving the private sector

The Afghan government followed up its stated commitment to combat corruption with a number of steps over the last several years. These include the establishment of the High Office of Oversight and Anti-Corruption (HOOAC), and an anti-corruption strategy and implementing law.[4] Based on the discussion above, it is evident that pressure and resources from the international community were at least as decisive in these outcomes as the government's determination to confront the problem, which has come into question. These initiatives have focused largely on building public sector transparency and accountability. HOOAC has also established a complaints department with a hotline for reporting, as well as units dealing with private sector corruption. The Afghanistan Investment Support Agency (AISA), under the Ministry of Commerce, and the Afghanistan Chamber of Commerce & Industries (ACCI) have conducted workshops and other events to raise awareness and support development of integrity and transparency guidelines in the private sector. Government has also established units on Corruption Vulnerability Assessments and Corruption Risk Assessments, covering both public and private sectors, to guide staff in preventing corruption, and to provide a channel of communication to report corruption.[5]

A different kind of initiative is the ADB's investment in Afghanistan International Bank (AIB). A priority for this project was to institute strong corporate governance at the bank, both to ensure its sound operation and to help in setting an example and building pressure for integrity in the financial sector more generally. Thus, AIB's business processes were required to conform to international best practices. These are embodied in policies and procedure manuals dealing with internal controls, anti-money laundering, and other aspects of risk management. Three independent directors were chosen for the board. AIB's financial statements are prepared according to IFRS and audited by internationally recognized accounting firms, and the bank assists its clients in instituting these practices themselves.[6]

International standard[7]	Compliance by member country
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	Very few relevant initiatives, most under international donor influence.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) Government reports that HOOAC established a complaints department with a hotline for reporting, and units dealing with private sector corruption. 2) The Anti-Corruption Law (art.14) provides for immunity and protection of cooperating witnesses.[8]
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) Government reports that units in HOOAC, Interior Ministry, and others focus on preventing and detecting private sector corruption, and liaise with businesses. 2) and 3): AISA and ACCI have conducted workshops and other events to raise awareness and support development of integrity and transparency guidelines in the private sector.
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	Government reports that the High Office of Oversight has encouraged public commitments through the signing of MoUs with civil society, private sector, and other organizations to strengthen transparency and prevent corruption.

3. Internal controls

Afghanistan, contending with a difficult and unstable environment, has established some basic standards and procedures that can be further developed as the situation improves. It updated its old company legislation with the Corporations and Limited Liability Companies Law of 2007. The law contains limited provisions on internal control and financial reporting. There are no detailed standards on corporate governance apart from those applicable to banks, which we discuss below. Further, Afghanistan does not have a regulatory agency for corporations, public or private, as this is usually understood. The Afghanistan Investment Support Agency, established under the Law of Private Investment, is the only official body that registers companies. The World Bank reported in 2009 that AISA had registered nearly 10,000 entities, although several were thought to be dormant or defunct. Registration with AISA is now mandatory for most private sector enterprises apart from trading firms and small retailers, which register with other authorities. However, AISA is not responsible for monitoring company compliance with the Commercial Code of 1955 or with the Corporations and Limited Liability Companies Law.[9] The latter statute does contain a few provisions that in principle can help impose accountability on management, directors, and insiders – including articles on shareholder derivative actions and required disclosure of conflicts of interest by board members.[10]

A. Internal audit

There appears to be no provision for internal audit for companies generally, but internal audit is required for financial institutions under the Banking Law.

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	Government reports that audit laws apply to public and private sector organizations.[11]
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect "illegal acts" in the books and records of companies, including bribery and other forms of corruption.	1) and 2): IIA/IPPF standards are available as guidelines for companies seeking to follow best practice.
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	1) through 4): Government states that an Internal Audit Law applies, with respect to all financial statements, asset control and other issues related to internal audit, both to public-private sector.[12]

B. Audit committee

The Corporations and Limited Liability Companies Law (Companies Law) provides for the appointment of committees of the board of directors and requires the establishment of a board of supervisors (arts.46, 59-67). The shareholders elect the board of supervisors, who may not be members of the board of directors or their relatives. The board of supervisors' duties (which cannot be restricted by the corporate charter or bylaws) include the following:

- Cooperate with the board on the preparation and review of financial statements;
- Investigate the operations and books of the company every six months;
- Inspect the company treasury every quarter;
- Supervise the board's actions in carrying out its duties under the laws and company charter.

The Banking Law, 2003 (arts.22, 26), requires an audit committee for financial institutions. The committee is responsible for establishing accounting procedures, instituting accounting and risk management controls, supervising compliance with these procedures, and auditing the bank's accounts and records – including ensuring that internal audit is performed. The committee monitors compliance with laws and regulations, reviews transactions according to plan or by request of the board of supervisors or shareholders, and reports its findings and opinions to the board of supervisors. The committee is to have at least three members and hold office for no more than four years.

The central bank, Da Afghanistan Bank (DAB), issued a corporate governance code for banks in 2006.[13] The code provides for a supervisory board in similar fashion to the Companies Law, and also recommends the establishment of an audit committee of the board of supervisors[14] (arts.10.2.3-10.2.9). The majority of board of supervisor members should be representatives of shareholders. This board is expected to supervise bank operations to ensure that they reflect sound planning, are effectively governed by comprehensive policies and internal control procedures, and are administered by competent management. Operations should comply with the policies adopted by the board of supervisors and applicable laws and notifications, and be consistent with sound banking practices. The board hires the bank's executive officials, and must actively oversee the selection process, determine the compensation package, and define the circumstances under which managers are to be dismissed. Further, the board of supervisors should establish committees to handle matters that require detailed consideration. All committees should have clear written statements of their missions, authorities, and responsibilities, and report regularly to the full board of supervisors. An audit committee is recommended in order to monitor management's efforts to correct deficiencies discovered in an audit or a supervisory examination. The chief internal auditor should report to this committee.

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	1) Companies Law requires supervisory board, while Banking Law also requires audit committee for banks (also, audit committee of supervisory board recommended by DAB Corporate Governance Code). 2) Board and committee must have independent members. No requirement of financial expertise.
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers, employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	1) Audit committee (banks only) oversees accounting and audit, while supervisory board (all companies) works with directors on accounts. 2) Bank audit committees oversee internal controls, compliance with laws. 3) to 5): Government points out that it has established (through HOOAC) Vulnerable Corruption Assessment (VCA) and Corruption Risk assessment (CRA) units, both in public and private sector to guide staff and prevent corruption, and also to provide a channel of communication to report corruption.[15]

C. Internal control and compliance systems

There are no internal control standards for companies in general, apart from the control exercised by management, the board, and the board of supervisors as mentioned above. Explicit standards are applied to banks, however. The Banking Law (art.12) states several requirements for award of a banking license, including a finding by DAB “that the internal control and risk management procedures of the bank will be adequate.” The DAB Corporate Governance standards (art.10.2.5-10.2.8) provide more detail. The board of supervisors is charged with instituting policies on management of risks in such areas as credit approvals, asset and liability management, and a code of ethics that deals with conflicts of interest among other issues. The board of supervisors, in overseeing the implementation of its policies, should ensure that management incorporates a sound system of internal controls into the bank's day-today operating procedures. Policies and procedures should be reviewed and adjusted periodically to deal with new risks. The standards propose several rules and procedures to minimize conflicts of interest involving the board of supervisors and other company organs.

International standard	Compliance by member country
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees. 4) Risk-based approach: • Individualized assessment of risks to the enterprise, including corruption risks. • Regular monitoring and re-assessment of corruption risks.	1) Internal control systems required of banks only, per Banking Law. No disclosure requirement. 2) DAB Corporate Governance norms recommend oversight by audit committee, e.g. of management response to audit problems, for banks. 3) Government states that this is required by the Partnership Company Law, Commercial Procedure Code, and Business Corporation and Limited Liability Companies Law.[16] 4) Internal control (banks only) includes policies on risk management dealing with credit and asset management, and ethics (e.g. conflicts of interest). No express mention of corruption. Government cites in this context the laws listed in item (3) above and the VCA and CRA units established by HOOAC.
Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements. 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment,	1) Audit committees of banks monitor compliance with laws. 2) through 4): Government cites HOOAC and the Anti-Corruption law, which prohibit bribery and other forms of corruption and provide guidance as well as oversight.[17]

political contributions, charitable donations. 4) Require for third-party representatives, consultants, or agents: • Written contract, adherence to company ethics standards and anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	
Enforcement, including sanctions for failure to comply.	Government reports that the Attorney General's Office has proposed corruption- related laws with sanctions specifically defined.[18]

4. Integrity of financial statements

A. Accounting

1. Financial records

The Companies Law (art.87) provides for the keeping of financial records, including books of account, by "any information storage device or method, provided that the records are clear, in legible form and usable" and are available upon request to anyone entitled to see them. No retention period is fixed. The signing of fraudulent documents is prohibited, but this applies only to those sent for recording to the Central Registry, which would not include account books or other source documents (art.113). In the case of financial institutions, the Banking Law(art.32) requires them to maintain adequate accounting and other records of business, and imposes a ten-year retention period for records of transactions including applications and contracts, financial records used in approving transactions, and account agreements (art.39) . These records may be kept in electronic form, provided adequate data recovery systems and procedures are in place. Banks are not allowed to keep accounts for undisclosed persons (art.41).

International standard	Compliance by member country
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	All companies required to keep proper records per Companies Law, but 10-year retention period applies only to banks per Banking Law.
Prohibitions (UNCAC 12(3), OECD Convention 8(1)), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	1) Companies Act prohibits registering fraudulent documents but not false accounting records as such. 2) Banking Law: no destruction before 10 years. 3) through 6): No explicit provisions, though these come under general financial reporting standards (see below). Banking Law does not allow undisclosed account-holders.

2. *Financial reporting requirements*

All companies must produce annual financial statements including balance sheet and profit and loss statement (Companies Law, art.54). The statements are to “include all operations of the company” and comply with IASB standards. Despite significant progress on the legal-regulatory framework in recent years, Afghanistan has no local accounting or auditing standards, professional regulator, corporate regulator or oversight organization. The government reports that it has approved a manual for accounting and financial reporting. The World Bank reported in 2009 that financial statements, which are expected to be prepared in accordance with international standards, are usually incomplete, if at all available. The quality of financial statements and compliance with auditing standards were reported to be poor, with a few exceptions, particularly in the banking sector. Under the Banking Law (art.42) and DAB policy, adherence to IFRS is mandatory. The banks have to make their annual audited financial statements available to the DAB, their shareholders, and the public within three months after the end of their financial year. In the case of banks with subsidiaries, the parent company financial statements as well as consolidated financial statements must be presented. Banking is the only sector where financial statements are consistently available and of reasonable quality, according to the World Bank’s report (World Bank 2009: 4-18).

International standard	Compliance by member country
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs.[19] 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) There are no national accounting standards, and so IFRS are used. The IFRS are mandatory for banks, per Banking Law and DAB policy. Government has approved an accounting and financial reporting manual. 2) No provision. 3) Disclosures must include these items per IFRS 10, but especially for companies other than banks, actual IFRS compliance is only partial at best.
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) and 2): In practice, banks and some other companies comply with IFRS including IAS 37 on contingent liabilities. The rule would not normally require disclosure of future effects of corruption.

B. Audit

1. Auditing requirements

In Afghanistan, statutory audits are not required (even for SOEs) except for financial institutions. The Companies Law carries over provisions of the Commercial Code of 1955 assigning the auditing and investigative function to the board of supervisors, consisting of two persons appointed by the board of directors, rather than an external auditor. The Code also requires the board of supervisors to submit audited financial statements to the AGM, and does not specify any kind of professional qualifications for a person to act as a supervisor. In the absence of national standards, audit firms are often expected to follow International Standards on Auditing (ISA), as set by local legislation, business practice or international network requirements. As mentioned above, the quality of financial statements and compliance with auditing standards are poor, with some exceptions (mainly banks). The World Bank in 2009 found a "serious lack of qualified staff of entities in Afghanistan who understand ISA." Some auditors have made efforts to carry out audits as per international standards, but they cite the lack of understanding on the company side as a major constraint in discharging their professional responsibilities (World Bank 2009: 4-19).

The Banking Law (arts.43-44) and DAB policy require banks to have annual external audits in conformity with ISA. A bank must appoint an independent auditor with qualifications and experience acceptable to DAB to perform an annual audit in compliance with standards issued by regulation of DAB (i.e., ISA). Audited financial statements are to be filed with DAB and published in national newspapers (World Bank 2009: 18). The auditor is also required to assist the bank in maintaining proper accounting systems, financial controls, and risk management procedures. The auditor provides to the board of supervisors an annual audit report with an opinion on whether the financial statements present a full and fair view of the financial condition of the bank. Within three months of the end of the financial year, the auditor is to file the company's audited consolidated financial statements with DAB, and make them available to the shareholders.

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	Auditing controls do not appear to be sufficient, since only banks are required to perform external audits and understanding of audit standards is limited.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	1) Per Banking Act and DAB policy, banks must have annual audits and publish audited accounts. No such requirement for other companies. 2) No special rules for SMEs.
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	ISA are accepted as the standards for all audits, and are mandatory for banks (Banking Act and DAB policy) – including ISA 240, 250. These have not been formally adopted by Afghanistan.
Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks. 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	1) Bank auditors must certify accuracy of accounts and provide an opinion on their preparation. No requirement of internal control testing, though auditor is expected to work with the client company to ensure controls are in place. 2) Government reports that this is an obligation under the Partnership Company Law, Commercial Procedure, Business Corporation and Limited Liability Companies.

2. Auditor reporting of improprieties

As discussed above, companies other than banks sometimes conduct audits but are not required to do so; accounting oversight or assistance is provided by the board of supervision. No external reporting is envisioned.[20] Under the Banking Law (art.43), auditors of banks must inform DAB about any act by an administrator, employee, or agent of the bank that constitutes a material violation of the Banking Law or any regulation or order issued by DAB. The auditor must also inform DAB of any irregularity or deficiency in the bank's administration or operations that can be expected to result in a material loss for the bank. There is no explicit safe harbor provision to protect an auditor from liability for such reporting.

The Kabul Bank crisis provides the most obvious case where this reporting provision should have been invoked. But massive ongoing fraud was not reported, and resulted in a bank run and losses in the range of USD 900 million. In this case, the political power of Kabul Bank is thought to have placed it in a superior position to DAB. The US-funded accounting firm assisting DAB apparently knew about the fraud but did not report it to the US aid agency for reasons of confidentiality in its client relationship with DAB. This helped to produce a crisis and a loss of confidence in the banking system, as well as a failure in the US project – the accounting firm was dismissed from the project. The key issue appears to be that Kabul Bank was too powerful to be reined in, even if the auditors and the regulator knew about the fraud.[21]

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	Internal reporting required by ISAs, which apply to banks per Banking Act and DAB policy. Other companies may conduct audits and may use ISA but are not required to.
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").	1) and 2): ISA 240 and 250 in principle support external reporting in special cases, but this is unlikely without a safe harbor provision. Banking Act requires reporting by bank auditor to DAB of legal violations or irregularities likely to cause a material loss. This could in some cases require reporting of fraud and corruption (as in Kabul Bank case), but only if material loss is threatened. No safe harbor provided.

C. Professional standards and independence

Afghanistan has an accounting and auditing profession only in a very limited sense. The profession is not formally organized or governed, and there is an acute shortage of qualified professionals. The number of resident foreign-qualified Certified or Chartered Accountants in Kabul was estimated in 2009 at less than twenty. International consultants and accountants are hired at premium rates and are being used in various accounting, audit, advisory and consulting roles. The local branches of large international accounting firm networks dominate the limited audit market in Afghanistan, including auditing almost all the banks operating in the country. There are 16 approved accounting and auditing firms registered with AISA. Most of these firms are branch offices of South Asian accounting and auditing firms, some of them having only a single professional, while others are offices of the larger international accounting networks. It is not uncommon for unqualified accountants to be partners in an audit firm, especially in small firms. Afghan students can obtain an accounting certification with little or no prior formal education. No audit law, code of ethics, or regulator governs accounting and audit practice (World Bank 2009: 15).

There are ongoing efforts to improve the legal and professional governance frameworks for accounting and auditing. New laws have been proposed and professional associations founded. The government reports that the Institute of Accountants and Auditors of Afghanistan (IAAA) has been established as planned. The international community is active in embedding professionals in DAB and other agencies, providing technical assistance and training, and setting up educational programs.[22]

The Banking Law has clear provisions on the appointment of external auditors. DAB approval is required for appointment and re-appointment of all bank auditors. DAB issued an External Audit Approval Process Policy with detailed provisions for the appointment of external auditors. The policy provides for the independence of auditors, qualifications and membership requirements, auditor appointment and termination, scope of work for external audit, audit report format, internal procedures for the use of audit reports by DAB, and expected contents of a management representation letter. The appointment of auditors is made annually by the AGM (World Bank 2009:14).

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) and 2): Until recently, no formally organized profession, agreed professional training program, or ethics code. Major assignments handled by branch offices of foreign firms. Government has established the IAAA to govern the profession.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	1) through 5): DAB rules provide for appointment procedure, safeguards of independence, and rotation of external auditors. Government states that audit laws and regulations in Afghanistan provide all the required protections for auditor objectivity.[23]
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) through 4): New laws being proposed, and some professional associations operating including IAAA. Formal professional standards are under development. Again, as above, Government states that audit laws and regulations in Afghanistan provide all the required protections for auditor objectivity. [24]

D. Enforcement

We have not been able to review any specific provisions enforcing the laws on financial reporting, auditing, or professional practice. Some legal provisions refer to sanctions in the penal code. In other cases, laws contain enabling provisions for the regulator to apply appropriate sanctions. Thus, the Banking Law (art.42), for example, provides that DAB may impose sanctions on financial institutions, managers, and agents in the event of financial reports that are late, incomplete, inaccurate, or intentionally false or misleading. The penalties are not defined.

International standard	Compliance by member country
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2): Government states that the Attorney General's Office and HOOAC have proposed corruption- related laws that define strong, specific sanctions.[25]
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) through 3): As above.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) through 3): As above.

5. Conclusion and recommendations

A. General efforts to prevent corruption involving the private sector

The Government of Afghanistan has made a number of steps and commitments towards dealing with the country's intractable problems of corruption. The establishment of an anti-corruption body, with the adoption of a strategy and implementing law, signaled a desire at least to be seen as getting tough on public sector corruption. But implementation has been ineffectual, and has not led to serious action to address corruption involving the private sector.

Recommendations

1) Incorporate private sector anti-corruption initiatives into the work of the HOOAC and programs promoting private sector development.
2) Support integrity pacts, for example in government procurement projects, and couple them with channels for complaints and self-reporting on corruption.

B. Internal controls

Despite the adoption of a new company law in 2007, Afghanistan has corporate governance standards only for the banking sector. Internal audit, audit committee, and internal control and compliance systems are required only for banks. Some of the responsibilities related to these functions are handled by the boards of supervisors required of all corporations. Moreover, there is no corporate regulator as such, but only an investment body where companies must register.

Recommendations

1) Expand requirements for the various internal control-related functions beyond the banking sector to other companies, perhaps larger public companies.
2) Support internal auditor training and dissemination of IIA standards.
3) Develop and disseminate a corporate governance code for non-financial companies.

C. Integrity of financial statements

Financial records are to be kept by companies, but there is no required retention period except in the case of banks. All companies must produce financial statements according to accepted accounting principles. The financial reporting standards used are the IFRS, although these are mandatory only for banks. In practice, financial statements tend to be incomplete and not fully compliant with IFRS. Companies in general are not required to perform external audits, although for banks, annual audits based on ISA are required. But there is limited understanding of ISA among businesses. Auditors are not required to report fraud and corruption to the authorities except in the case of material violations by banks. The accounting and auditing profession in Afghanistan is just beginning to be formally organized, and most major work is done by foreign firms. Professional qualifications, ethics, and discipline are not defined, although appointment safeguards for bank auditors are set by DAB. Last, there appear to be virtually no specific sanctions provisions backing up the rules in this area.

Recommendations

1) Define an accounting record retention period for all companies.
2) Support training of businesses and accountants in IFRS and ISA, and begin the process of formal adoption of these standards with appropriate exceptions for SMEs.
3) Adopt a safe harbor provision to protect auditors reporting fraud and corruption to external authorities.
4) Support the IAAA or similar professional body that can develop into a licensing, standard-setting, and disciplinary institution.
5) Clarify sanctions for corporate governance and financial reporting-related rule violations.

Afghanistan Laws, Regulations, Policy Documents Referenced:

Banking Law, 2003, http://www.trade.gov/static/afghanistan_bankinglegislation.pdf.

Commercial Code Law of State Owned Enterprises

Commercial Code of 1955

Corporations & Limited Liability Companies Law of 2007, http://en.afghanembassy.in/files/commercial/COMPANIES_LAW.pdf

DAB External Audit Approval Process Policy

Da Afghanistan Bank Law, http://www.centralbank.gov.af/pdf/UpdatedOfDaAfghanistanBankLaw_1_.pdf

Da Afghanistan Bank (2006), *Article Ten: Corporate Governance*, Islamic Republic of Afghanistan, http://www.centralbank.gov.af/pdf/CorporateGovernanceRegulationFinal.pdf

Law of Private Investment

Law on Overseeing the Implementation of the Anti-Administrative Corruption Strategy (2008 UNODC translation), http://anti-corruption.gov.af/en/page/8477

Strategy and Policy for Anti- Corruption and Administrative Reform, Islamic Republic of Afghanistan, http://anti-corruption.gov.af/en/page/8477

NOTES

[1] http://www.bti-project.org/reports/country-reports/aso/afg/index.nc.
[2] IFC, *Doing Business 2011, Making a Difference for Entrepreneurs: Afghanistan*, pp.37-42.
[3] http://www.bti-project.org/reports/country-reports/aso/afg/index.nc.
[4] Law on Overseeing the Implementation of the Anti-Administrative Corruption Strategy (2008 UNODC translation, “Anti-Corruption Law”), http://anti-corruption.gov.af/en/page/8477; *Strategy and Policy for Anti Corruption and Administrative Reform*, Islamic Republic of Afghanistan, http://anti-corruption.gov.af/en/page/8477.
[5] Government comments.
[6] ADB (2010), “Equity Afghanistan: Afghanistan International Bank,” Extended Annual Review Report, p.25-27.
[7] The sources of all standards are provided in footnotes to the tables presented in the section of the Review entitled *International Standards for Country Reports.*
[8] The text does not mention sentence mitigation for self-reporting, but Government states there is a legal basis for it.
[9] World Bank (2009), *Afghanistan Report on Observance of Standards and Codes (ROSC) Accounting & Auditing*, pp. 4-10.
[10] Corporations & Limited Liability Companies Law of 2007, arts. 48, 50, http://en.afghanembassy.in/files/commercial/COMPANIES_LAW.pdf. Also government reports that the Supreme Audit Office (SAO), Internal Audit Office, and Central Bank Oversight Unit establish standards relevant to internal control in state enterprises and the private sector.
[11] This statement has not been corroborated. The only audit-related law available in translation is the Audit Law that deals with the audit of state agencies and state enterprises by the government’s supreme audit institution.
[12] This statement has not been corroborated. As the text indicates, the documents reviewed by the consultant show only that internal audit is required for banks. In terms of international good practice and proportionality, this is a reasonable approach for Afghanistan. No requirements have been found for other companies, although some of these functions fall within responsibilities of board committees (see below).
[13] Da Afghanistan Bank (2006), Article Ten: Corporate Governance, Islamic Republic of Afghanistan.
[14] Distinct from the separate audit committee required by the Banking Law.
[15] While these units may take on certain responsibilities typical of audit committees, it is important to note that these units are government entities quite separate and distinct from audit committees as the latter are understood in international practice.

[16] This statement has not been corroborated. The consultant was able to review only the Business Corporation and Limited Liability Companies Law, and found no such provision.

[17] While these institutions may have an impact on companies' activities with respect to internal control systems to prevent fraud and corruption, they are separate and distinct from any legal provisions requiring companies to establish such control systems. The consultant has found no legal provisions that require private sector companies to adopt internal control systems dealing explicitly with corruption. The requirements applicable to banks appear to call for such controls, but do not specify them as such.

[18] Again, it is possible that such laws will encourage companies to adopt more effective internal controls, but such laws are separate and distinct from laws or regulations that require companies to set up such controls.

[19] Small and Medium-sized Enterprises.

[20] For government departments and state enterprises, any external auditors of the Supreme Audit Office who discover fraud or corruption must report it to their superiors or to the Attorney General's Office. Government comments.

[21] Alissa Rubin and James Risen, "US Agency Ends Accounting Firm's Afghan Contract," *The New York Times*, March 17, 2011, http://www.nytimes.com/2011/03/18/world/asia/18afghan.html?_r=0.

[22] World Bank (2009: 16); http://www.wadsam.com/afghanistans-accountants-and-auditors-association-established-989/; http://www.pragmacorp.com/ar.htm.

[23] This statement has not been corroborated.

[24] This statement has not been corroborated.

[25] This statement has not been corroborated. It must also be noted that anti-corruption laws, while they may encourage improvements in financial disclosure by companies, are separate and distinct from legal sanctions specifically targeted at compliance with financial accountability standards and procedures.

Australia

1. Introduction

The regulatory environment in Australia is one of the world's most transparent, efficient and open to foreign investors. Property and contractual rights are secure, enforced by an independent and well-functioning judiciary. Moreover, both domestic and foreign companies enjoy substantial flexibility in licensing, regulation and employment practices. The public procurement system in Australia is transparent and well regulated, according to the US Department of State, thus limiting opportunities for corrupt practices in this field. Australia is considered one of the most corruption-free countries in the world. A recent report by the World Economic Forum ranked corruption as one of the least problematic factors for doing business in the country.

Australia's problems of corruption are typical of a wealthy developed country, tending to arise from the influence of money on politics and to a lesser extent foreign bribery. Political parties are usually sponsored by donations from the country's biggest corporations and trade unions, with MPs actively engaged in raising funds for their political parties. Public concern has grown about the increasing threshold for mandatory disclosure of political donations (in 2011 reaching AUD 12,000 or USD 11,000[1]) and the absence of an upper limit for donations. Transparency International surveys show that political parties are seen as the most corrupt institutions in the country, with the private sector not far behind. Several political corruption scandals came to light in 2012. These include the arrest of businessmen for bribe payments to Aboriginal land councils to facilitate acquisitions for development, and a corruption inquiry into allegations of improper sharing of inside information on mineral exploration bids by a former federal minister. The same year, an arrest was made and proceeds of AUD 40 million (USD 36 million) seized in connection with a tax evasion and money laundering scheme.

Australian companies in a 2012 Deloitte survey reported increasing exposure to foreign bribery and corruption in offshore operations. Among firms in high-risk industries such as energy, manufacturing, and financial services, 21% reported having experienced corruption incidents in the preceding five years. Only 25% of the surveyed executives reported that their company had a comprehensive understanding of relevant legislation, and almost half of all companies did not have any formal policy or compliance program to manage corruption risk. The OECD, concerned about weak enforcement of foreign bribery prohibitions, reported that only one foreign bribery case over a period of 13 years led to prosecution. The report also found that anti-corruption legislation creates confusion about the scope of the facilitation payment defense, and therefore weakens compliance with record-keeping requirements.

Australia has been active in contending with these problems. The country has well-established and successful anti-corruption bodies such as the Independent Commission Against Corruption (ICAC) of New South Wales. The Criminal Code, the Public Service Act, and others criminalize public and private sector corruption, attempted corruption, extortion, bribery of foreign public officials, and both active and passive bribery.

2. General efforts to prevent corruption involving the private sector

Australia has ongoing a range of corruption prevention efforts sponsored by federal and provincial government, civic organizations, and private sector associations. As mentioned, ICAC has been a leader in this regard for New South Wales, Australia's most populous and influential province. Part of ICAC's role is to educate the community about corruption by such means as maintaining current online information on investigations and approaches to prevention, providing tailored advice to meet the needs of specific community groups, conducting outreach programs particularly to rural areas and vulnerable population groups, and encouraging media attendance at public inquiries. ICAC publishes reports and guidebooks in several languages, including a resource for public officials to develop a statement of business ethics to be followed in their dealings with the private sector.[2] Parallel bodies in other regions have similar mandates, such as the Corruption and Crime Commission of Western Australia, which conducts regular awareness-raising and emphasizes individuals' responsibility to report corruption.[3]

Government and business associations actively promote integrity in the private sector. For example, government has agreed to a pilot program under the Extractive Industries Transparency Initiative (EITI), an international alliance of public, private, and civic groups concerned with oversight of payments from natural resources. Under the EITI pilot, which began in 2012, Australia undertook to assess the transparency of its financial reporting arrangements for the resource sector against EITI principles. Further, the Australian Tax Office (ATO) has issued guidelines on preventing and detecting foreign bribery, and provided training to SMEs on bribery and facilitation payments. Business community groups such as the Australian Shareholder Association advocate for policies to enhance corporate transparency and governance, including more stringent limits on companies' political campaign contributions. The Council of Standards Australia has made important contributions, providing tools for monitoring corporate integrity and preventing corruption in the form of its business standards, including standard AS 8001-2008, *Fraud and Corruption Control*. The standard provides a best practice guideline for managing fraud and corruption risks in private sector companies and other organizations. The standard addresses such matters as the role of internal audit in controlling the risk of fraud and corruption, risk assessment methodology, employment screening guidelines, and new customer and supplier screening guidelines. [4]

As for self-reporting of fraud and corruption, both ICAC and the Australian Securities and Investments Commission (ASIC), among others, provide channels and formats for such reports. ASIC publishes undertakings entered into by businesses admitting violations of its rules, including those on corporate governance and financial reporting.[5]

International standard[6]	**Compliance by member country**
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	Stand-alone and cooperative efforts underway involving government, private sector, NGOs, and communities.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) NSW ICAC and parallel institutions provide channels for reporting corruption offenses. 2) Provision for self-reporting of corruption offenses by offenders by ICAC, ASIC, and others.
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) NSW ICAC and parallel institutions provide guidance on prevention to communities and public sector. Standards Australia issues codes on fraud and corruption prevention for businesses and others. 2) and 3): Standards Australia, ATO, and ASX (see below) provide guidelines on ethics, compliance, and other aspects of corporate governance.
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	Australian government, private sector, and NGOs are piloting EITI. Other uses of integrity pacts are not in evidence.

3. Internal controls

A. Internal audit

Internal audit is not a requirement of company or securities legislation, but is instead incorporated in good corporate governance principles monitored by regulators. The Australian Securities Exchange (ASX) has taken a leadership role in strengthening corporate governance practices by convening the ASX Corporate Governance Council. The Council brings together business, shareholder, and industry groups, each offering a distinct expert perspective on governance issues. The Council produced a set of *Corporate Governance Principles and Recommendations*[7] on governance practices to be followed by ASX-listed entities, in order to promote investor confidence and to assist listed entities to meet stakeholder expectations. Under ASX Listing Rule 4.10.3, listed companies are required to benchmark their corporate governance practices against the Council's Principles and Recommendations and, where they do not conform, to disclose that fact and the reasons why. This "comply or explain" rule uses the authority of the Exchange to encourage and speed the adoption of best practice, while allowing company boards the flexibility to choose alternative approaches, provided these can be explained adequately.[8]

As regards internal audit, the Principles (p.33) recommend establishing such a function to conduct independent analysis and appraisal of the company's risk management and internal control systems. An alternative mechanism may be used to achieve the same outcome, depending on the company's size and complexity, and the types of risk involved. The internal audit function should be independent of the external auditor. The internal audit function and the audit committee should have direct access to each other and should have all necessary access to management and the right to seek information and explanations. The audit committee should provide oversight and assessment of internal audit (see below). Australian Standard 8001 outlines a key role for the internal audit function in controlling fraud and corruption.[9] The country also has a chapter of IIA that for some 60 years has organized, developed, and supported the internal audit profession.[10]

Australia has provided survey findings that indicate the prevalence of internal audit in practice. Grant Thornton Australia reported in 2013 that, among all of the top 500 listed companies that it reviewed, nearly half (46%) disclosed that they had an internal audit function, with the proportion much higher in the top 100 (88%) and much lower (22%) in the companies ranked 401-500. The declining trend (prevalence of internal audit decreasing with company size) would likely hold among firms outside the top 500.[11]

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	Listed companies are encouraged or pressured by ASX to have such controls, and these are subject to monitoring. As to other companies, this is not clear.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect "illegal acts" in the books and records of companies, including bribery and other forms of corruption.	1) and 2) Australia has a long-established chapter of IIA that provides technical information and training, and applies global IIA standards.
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	1) and 2): Per ASX Corporate Governance Principles, basic and risk-based audit of accounting and risk management recommended. 3) Australian Standard 8001 advises methods of corporate fraud and corruption control, and provides for internal audit role in this. 4) Internal audit should report to and be overseen by audit committee.

B. Audit committee

The ASX Corporate Governance Principles address the need for an audit committee. The Principles document notes (p.4) that ASX Listing Rule 12.7 requires companies in the S&P All Ordinaries Index (an index of the largest 500 companies on the ASX) to have an audit committee. Companies in the top 300 of that Index must follow the Recommendations of the ASX Corporate Governance Council on the composition, operation and responsibility of the audit committee – set forth in Principle 4. For other listed companies, the Principles are guidelines that serve as a point of reference for corporate governance practice and for oversight by ASX.

Principle 4 states that companies should have an independent structure to verify and safeguard the integrity of their financial reporting. The Recommendations specify that the board should establish an audit committee with a formal charter, having three or more members – all non-executive directors, a majority of them independent – and chaired by an independent director (not the chair of the board). The committee should have financially literate members, including one qualified accountant or finance professional with relevant experience. The charter should clearly set out the audit committee's role and responsibilities, composition, structure and membership requirements. The audit committee should be given all necessary powers and resources, including rights of access to management, rights to seek explanations and additional information, and access to auditors (internal and external) separately from management. Smaller boards may determine that a formal audit committee is not efficient. If they choose not to have such a committee, they should have board processes in place to raise the issues that would otherwise be considered by the audit committee. A company in this situation should disclose how its alternative approach assures the integrity of financial statements, and why an audit committee is not considered appropriate (ASX 2010: 25).

The reporting of the audit committee is considered in detail. It should report to the board on all matters relevant to the committee's role and responsibilities, including the following (ASX 2010:26):

- management of financial reporting, and whether financial reports are adequate and consistent with the committee's information
- recommendations on selection (and removal) of external auditor, procedures for appointment and rotation, assessment of independence and performance (including impact of auditor's provision of non-audit services)
- recommendations on appointment (and dismissal) of internal audit head, and assessment of the performance and objectivity of the internal audit function
- the results of the committee's review of risk management and internal control systems.

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	1) Large listed companies required to have audit committees, other issuers encouraged to do so by ASX Principles (comply or explain). 2) ASX Principles (listed companies): Committee should be all non-executive directors, majority (and chair) independent, with accounting/finance expert.
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers, employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	Per ASX Principles (listed companies): 1) Audit committee to supervise financial reporting, internal and external audit appointments and performance. 2) Committee to review internal controls and risk management. 3) and 4): Covered by AS 8001-2008. 5) No provision.

C. Internal control and compliance systems

As in the areas just discussed, Australia relies largely on voluntary guidelines for listed companies, embodied in the ASX Principles and Recommendations. Principle 3 advises that companies should actively promote ethical and responsible decision-making. This involves establishing a code of conduct defining the practices necessary to maintain confidence in the company's integrity, ensuring compliance with legal obligations, and allocating responsibility to individuals for investigating and addressing reports of unethical practice. Companies should formulate policies on appropriate behavior of directors, senior executives, and employees, and incorporate these into company-wide management practices. Appropriate training, compliance monitoring, and regular updating should be used to reinforce the code of conduct and demonstrate the commitment of the company to ethical practices. Companies should also consider making advisers, consultants and contractors aware of the company's expectations as set out in the code of conduct. Last, the content and application of the code should be disclosed publicly (ASX 2010: 21).

The code should address such matters as the following (ASX 2010:22):

- Give a clear commitment by the board and senior executives to the code of conduct, linking this to statements about the company's aspirations and its obligations to stakeholders.
- Describe the company's approach to business courtesies, bribes, facilitation payments, inducements and commissions.
- State the measures the company follows to promote active compliance with legislation wherever it operates.
- Specify how the company handles actual or potential conflicts of interest.
- Identify measures the company follows to encourage the reporting of unlawful or unethical behavior and to promote ethical behavior.
- Describe the means by which the company monitors and ensures compliance with its code.

The importance of internal codes for companies more generally is underlined by AS 8002-2003, *Organizational Codes of Conduct*.[12]

ASX Principle 7 recommends that companies should establish a sound system of risk management and internal control. This includes establishing policies for the oversight and management of material business risks, and disclosing a summary of those policies. To achieve this, the board should require management to design and implement the risk management and internal control system, and report to it on whether those risks are being managed effectively. The board should disclose whether it has received assurance from the chief executive officer and chief financial officer (or their equivalents) that the certification of financial reports is founded on sound risk management and internal control systems, and that the latter are operating effectively in relation to financial reporting risks. Risk management policies should reflect the company's risk profile and should clearly describe all elements of the risk management and internal control system and any internal audit function. As part of its oversight for the risk management and internal control system, the board should review the effectiveness of the implementation of that system at least annually, and explain any deviations from Principle 7 in the annual report (ASX 2010:32-33).

The OECD's 2012 report on these matters found that the Australian government had made efforts to promote corporate compliance measures to prevent and detect foreign bribery. It referred to Australian Tax Office guidelines that suggest measures such as corporate codes of conduct and monitoring third-party agents and intermediaries. It also found that, compared to US and UK companies, few Australian businesses had measures to manage bribery risks. Such measures exist at some large pharmaceutical and shipping companies, but are rare among SMEs (OECD 2012:34).

International standard	Compliance by member country
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees. 4) Risk-based approach: • Individualized assessment of risks to the enterprise, including corruption risks. • Regular monitoring and re-assessment of corruption risks.	Per ASX Principles 3, 4, and 7: 1) "Comply or explain" approach requires explanation of any deviation from Principles on internal control or risk management. 2) Board is responsible for ensuring financial reports are proper and based on sound risk management. Audit committee should monitor and assess. 3) Senior management to show corporate commitment to code and compliance, and maintain training program. 4) Risk-based approach recommended, with annual assessments and regular updates.

Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements. 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations. 4) Require for third-party representatives, consultants, or agents: • Written contract, adherence to company ethics standards and anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	Per ASX Principles 3, 4, and 7: 1) Adherence to laws and standards should be included as a duty in corporate codes. 2) and 3): Policies on commissions, facilitation payments, and bribery should be included. 4) Agents, consultants, etc. should be made aware of company expectations under code of conduct.
Enforcement, including sanctions for failure to comply.	Exchange and regulatory authorities encourage compliance, and can exert pressure.

4. Integrity of financial statements

A. Accounting

1. Financial records

The Corporations Act[13] provides for the keeping of financial records, which are defined (art.9) to include invoices, receipts, checks, promissory notes, vouchers, and the like; original entry records; and working papers needed to explain the method of preparing financial statements. A company or other entity under the Act must keep written financial records that correctly record and explain its transactions and financial position, and enable true and fair financial statements to be prepared (art.286). Financial records must be retained for seven years. Failure to do so is a strict liability offense under the Criminal Code. Electronic records must be convertible to hard copy and made available in a reasonable time. If records are kept outside Australia, the Australian Securities and Investment Commission (ASIC) must be notified of the location, and sufficient written information must be kept within Australia to enable true and fair accounts to be prepared (Corporation Act, arts.288-289). The Act (arts.988A-G) has parallel provisions for financial institutions that include more detailed requirements for the kinds of information to be kept on banking business, and authorization of further regulations in this area.

The Corporations Act (arts.295-7, 1306-7) also addresses the integrity of company books. A corporation must ensure that its accounts comply with applicable standards and provide a "true and fair" view of the financial state (officers of listed companies must make a declaration to this effect). A company must also take all reasonable precautions to prevent damage, destruction, or falsification of records and to ensure timely discovery if any of these things do occur. Individual officers, employees, and members of a company are liable for an offense if they contribute to the concealment, destruction, mutilation or falsification of any books relating to affairs of the company. Failure to record book-keeping information properly, with knowledge or intent to falsify or destroy, is likewise an offense. Province-level laws also impose restrictions (OECD 2012:33).

International standard	Compliance by member country
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	Per Corporations Act: All companies (and other entities under the Act) to keep proper records, retaining them for 7 years.
Prohibitions (UNCAC 12(3), OECD Convention 8(1)), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	Per Corporations Act: 1) and 2): Falsification, damage, improper destruction are prohibited, and companies must take necessary steps to prevent this. 3) to 6): Off-the-books dealings and false record entries not explicitly prohibited, but generally covered by provisions on compliance with accounting standards.

2. Financial reporting requirements

The Corporations Act (art.292, 298) requires certain entities to prepare annual financial reports and accompanying directors' reports, including public companies, large private ("proprietary") companies, and other entities that report to ASIC. A large proprietary company meets two of these standards: at least AUD 25 million (USD 22.6 million) in consolidated revenue, AUD 12.5 million (USD 11.3 million) in consolidated gross assets, 50 employees (consolidated for all entities controlled by company (art.45A).[14] Private companies below this threshold need prepare financial reports only in particular circumstances, e.g. if directed by ASIC or 5% of shareholders to do so, or in some cases of foreign ownership (or if required by other legal provision). Financial reports required by the Corporations Act are to be filed with ASIC (arts.319-320).

The financial report must include financial statements, notes to the statements, and signed directors' declaration. The latter states whether the company will be able to pay its debts, whether the notes include "an explicit and unreserved statement of compliance with international financial reporting standards," and whether the financial statement in fact complies with accounting standards and provides a true and fair view (art.295). Listed companies must also provide a similar declaration by the CEO and CFO stating whether financial records have been properly kept (art.295A). Financial statements must in fact comply with accounting standards and provide a true and fair view of the financial position and performance of the company (arts.296-7). The directors' report provides key details of company operations, change in financial position, etc. Listed companies and others regulated by ASIC must file the above statements and reports with ASIC on a semi-annual basis (arts.299-306).

Financial reporting is governed by the Australian Accounting Standards Board (AASB), an independent statutory agency established under the Australian Securities and Investments Commission Act 2001.[15] AASB is empowered by the Corporations Act (art.334) to adopt accounting standards that are legally enforceable under the Act. Australian Accounting Standards incorporate IFRS verbatim (adding paragraphs on the applicability of each IFRS in the Australian environment), with new standards and amendments also included when they are issued by IASB. There are two tiers of standards:

- Tier 1: Australian Accounting Standards, incorporating IFRS. These must be used by private sector (for-profit) companies that have public accountability (including pension funds), as well as federal, state, and local governments.
- Tier 2: Reduced Disclosure Requirements. These include the recognition, measurement and presentation requirements of IFRS (IAS 1, 7, and 8), but with substantially reduced disclosures corresponding to those requirements. These rules may be used by private sector (for-profit) entities that do not have public accountability, any not-for-profit private sector entities, and public sector entities not included in Tier 1.

The main distinction between the tiers is public accountability, which is determined in the same way as it is under the IFRS for SMEs. The AASB has not adopted the IFRS for SME as such, but continues to monitor the development of those standards with a view to potential adoption at a later date.[16]

International standard	Compliance by member country
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) AASB has adopted IFRS (Tier 1) for publicly-accountable companies and most state entities. 2) Reduced Disclosure Rules (Tier 2) apply to other entities required to produce financial reports under Corporations Act. 3) Tier 1 includes IFRS 10, requiring consolidated reporting. Not required for Tier 2.
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) Companies applying Tier 1 standards must comply with IAS 37, which may but in practice usually does not require disclosure of possible liabilities due to corruption. 2) Corporations Act record-keeping rules prohibit falsification, but do not expressly mention corruption.

B. Audit

1. Auditing requirements

The Corporations Act (art.301) requires companies and other entities under the Act to have their financial reports audited. Small companies (either proprietary or limited by guarantee), including some subsidiaries (not consolidated in financial statements), are in certain cases exempt or subject to review rather than audit (e.g. financial statements but not audits requested by the regulator). Both annual and semi-annual financial statements are to be audited. The auditor is to provide an opinion as to whether the financial report complies with the Corporations Act, including conformity with accounting standards and the requirement of providing a true and fair view. The report must also state whether the auditor was given all information necessary for the audit, and whether the company has kept financial records sufficient to enable a financial report to be prepared and audited. The audit must be conducted according to audit standards, and the lead auditor is to ensure this, or strict liability applies. Audit working papers are to be kept for seven years. The auditor has the right of access to company books, and may require information, explanations, or other assistance needed for the audit or review. Company officers are required to cooperate with the auditor in providing access to the books as well as any needed information or other assistance (failure to do so is an offense of strict liability) , and auditors are required to report any attempt to mislead to ASIC (arts.307-12).

Audits must be conducted in accordance with the Australian Auditing Standards (ASA). These are developed by the Auditing and Assurance Standards Board (AUASB), an independent statutory body authorized to adopt standards that are legally enforceable under the Corporations Act (art.336). Australia adopted the ISA several years ago, and the AUASB has completed a program to reissue all the ASA in revised and clarified form in conformity with the revisions to the ISA. Audit professionals are required by the Accounting Professional and Ethical Standards Board (APESB) to use the standards issued by the AUASB for all audits undertaken in Australia (including non-Corporations Act audits). The ASA include the requirements of ISA 240 and 250 concerning the risks of material misstatement due to fraud or other failure of legal compliance. According to audit professionals, these standards require the auditor to consider risk factors for corruption, including foreign bribery, when planning an audit, and a portion of the audit should be dedicated to testing issues relevant to these risks. However, auditors were doubtful whether such misconduct is usually significant enough to be detected and disclosed in an external company audit.[17]

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	Auditing controls appear robust, though corruption prevention requirements are not explicit.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	1) Entities under Corporations Act to have financial statements (annual and semi-annual) audited. 2) Per the Act, smaller firms in some cases exempt from audit requirement or subject to review only.
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	Australian standards incorporate updated ISA, including ISA 240 and 250.
Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks. 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	Per Corporations Act: 1) Auditor must state opinion as to whether financial statements are in accord with IFRS, present a true and fair view, and appropriately prepared based on proper records. Testing of controls is part of audit standards and practice. 2) Directors certify financial statements, and CEO and CFO as well for listed companies. Failure to cooperate with auditor is penalized, as is falsification of records and statements.

2. *Auditor reporting of improprieties*

Under the ISA and ASA, external auditors must report fraud or possible fraud to management or those charged with the company's governance on a timely basis. They must similarly report instances of non-compliance with laws unless the non-compliance is clearly inconsequential or unintentional. Audit professionals have stated that they would report most cases of corruption and foreign bribery to management because the reputational and enforcement risks may materially impact the company's financial statements. Under the Corporations Act (art.311), auditors are required to report suspected violations of the Act to ASIC in writing. This applies to individual auditors, audit firms, and lead auditors, and to contraventions of the Act that are significant or that are unlikely to be handled effectively by reporting to the board, and also to any attempt to obstruct or manipulate the audit. Failure to report to ASIC within 28 days is an offense. Reporting under Section 311 falls within an express exception to an auditor's duty of confidentiality to her/his client under Section 1317AE of the Corporations Act. This reporting obligation is limited to Corporations Act contraventions (e.g. false accounting), and does not include breaches of the Criminal Code Act (e.g. bribery) – an anomaly in that the latter are often more serious (OECD 2012:34).

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	ISA/ASA 240 and 250 require internal reporting of fraud or illegality, and this in practice includes instances of corruption that may affect company financial statements.
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").	1) and 2): Corporations Act requires auditor reporting of certain contraventions of the Act to ASIC. This does not include corruption itself. Reporting to ASIC under the Act benefits from an exception to the duty of confidentiality, but external reporting under ISA/ASA 240 or 250 does not.

C. Professional standards and independence

The Accounting Professional and Ethical Standards Board (APESB) issues quality control standards applicable to all professional accounting firms, including assurance and non-assurance aspects of each practice. Audit practices are reviewed at least once every three years if they conduct Corporations Act audits requiring a registered auditor. Other practices are reviewed every five years, or in the case of many sole practitioners, are subject to self-assessment only. APESB is an independent governing body founded as an initiative of leading professional associations such as the Institute of Chartered Accountants in Australia (ICAA). APESB has adopted a Code of Ethics aligned with the IESBA Code and including clarifications in relation to the Australian context. The ICAA trains, governs, and supports accounting and audit professionals. It has a Professional Conduct Section that enforces the Code of Ethics and the Institute's bylaws and regulations. Sanctions include warnings, reprimands, cancellation of the Certificate of Public Practice, and exclusion from membership of the Institute. The ICAA also sets strict educational and training standards for membership, including the graduate diploma in accountancy, three years' experience, mentorship, demonstrated competence, and continuing education.[18]

The Corporations Act contains detailed requirements for protection and disclosure of auditor independence. Thus, listed companies must disclose in their annual directors' report details of amounts paid for non-audit services by the auditor, with a statement that the services did not compromise the auditor's independence. Services provided to affiliated companies must be included where reporting on a consolidated basis is required (art.300 (11B)). The auditor (or lead auditor in the case of a firm) must give the directors of the audited company a signed declaration that there has been no contravention of the auditor independence requirements of the Act or of professional conduct rules (or the statement must disclose any contravention). Failure to do so is an offense of strict liability by the auditor or the lead auditor of the firm, and in most cases the disclosures in the statement cannot be used as incriminating evidence in any trial (art.307C).

The Act also regulates appointment, resignation, and removal (arts.325, 329), and specifies that professionals who have a significant role in the audits of a company for five years (for listed companies, five of the last seven years) must have a two-year cooling-off period unless waived by the company or by ASIC (art.324DA). Conflicts of interest are defined, for individual auditors and firms, according to an “independence test” concerning financial interests and family ties, and a “maximum hours test” limiting non-audit services for an audit client to ten hours per year (or audit period) for each individual professional. Conflicts of interest must be resolved or reported to ASIC within seven days. Auditors cannot be hired by the audited company for two years after the appointment ends (arts.324CA-J).

In order to conduct corporate work, auditors and firms must comply with additional approval procedures and reporting requirements. Auditors and firms who carry out audits of entities under the Corporations Act must be registered for this purpose (art.324BA-BC). Auditors and audit firms carrying out audits of listed companies, banks, and a few other categories of institutions must publish annual “transparency reports” on their websites and submit them to ASIC. The content of the reports, addressing matters such as compliance with legal and professional standards, is provided in regulations (arts.332, 332A-B). ASIC oversees all auditing under the Corporations Act, receiving reports and granting approvals and waivers as appropriate.

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) APESB and ICAA govern the accountancy profession, setting qualification and education standards, and imposing discipline. 2) APESB has a Code of Ethics closely aligned to the IFAC/IESBA Code.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	Per Corporations Act: 1) Appointment and removal procedures defined. 2) Non-audit work for audited company limited to 10 hours per year (per professional) and subject to disclosure. 3) Key audit personnel require 2 years' cooling off after 5 years (listed companies: 5 out of 7 years). 4) Auditors' interests regulated in detail; conflicts must be reported to ASIC. 5) Employment of former auditors prohibited for 2 years.
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) ICAA sets qualification, education, other standards. Additional registration with ASIC and transparency reporting required for company auditors per Corporations Act. 2) ICAA sets requirements for ongoing training, applies APESB Ethics Code. 3) APESB provides independent oversight of audit practices. 4) ICAA enforces professional discipline.

D. Enforcement

The enforcement of financial reporting and corporate governance standards in Australia takes several forms. Certain offenses are treated on the basis of strict liability, so that only the fact of non-compliance must be established, without the need to show intent, negligence, or other elements. This simplifies enforcement of the rules, while sending a signal that compliance must be scrupulous. Offenses of strict liability under the Corporations Act include failure to maintain accounting records properly for the 7-year retention period, the failure to follow audit standards (ASA) in any statutory audit, failure by company officers to cooperate with the external auditor, and failure by an auditor to provide company directors with a signed declaration of the audit having been performed in compliance with professional and ethical standards. For such offenses, penalties in most cases consist of fines up to AUD 4,250 (USD 3,980) and up to six months' imprisonment. Other offenses may result in higher penalties, for example an auditor's failure to report illegalities or attempts to manipulate an audit to ASIC (Corporations Act art.311) can result in fines up to AUD 8,500 (USD 7,960) and imprisonment for up to one year.[19] Accounting and audit professionals are also subject to sanctions imposed by the ICAA, which can include warnings, reprimands, cancellation of the Certificate of Public Practice, and exclusion from membership of the Institute.

As in the case of the audit profession, ASIC and ASX are able to use their authority over companies' regulatory status to ensure compliance with standards. In this case, some of the standards are essentially voluntary (i.e. the Corporate Governance Principles), while others have the force of law and can be referred to the courts for enforcement (provisions of the Corporations Act). Australia's ability to allocate enforcement to these two different mechanisms is a strength that both encourages companies to internalize and self-enforce the rules, and economizes on enforcement resources. ASIC reports on the undertakings it has agreed with companies to remedy their having fallen out of compliance with the rules, another instance of flexible enforcement. In the case of ASX, companies are required by its Listing Rules to comply with the Corporate Governance Principles or explain any deviation. The Exchange takes these matters into account in regulating companies' access to ASX listings, another flexible but potentially effective enforcement tool. These measures appear to work in practice, although hard data on undertakings and compliance have not been available.

International standard	Compliance by member country
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2): It appears that the rules and procedures are effectively used in this way, although hard data have not been available.
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) through 3): Rules are enforced through a combination of strict liability, regulatory pressure, and professional sanctions. Civil, criminal, and administrative penalties are available. Penalties apply to individuals and/or companies depending on the case.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) through 3): Rules are enforced through a combination of strict liability, regulatory pressure, and professional sanctions. Civil, criminal, and administrative penalties are available. Penalties apply to individuals and/or companies depending on the case.

5. Conclusion and recommendations

A. General efforts to prevent corruption involving the private sector

Australia has a number of initiatives and established bodies in place to support public-private efforts against corruption. ICAC, the lead agency in this area for New South Wales, provides a wealth of information on investigations, and published resources such as guidebooks on compliance, reporting, and prevention. It also conducts regular outreach and offers advice to organizations in these areas. Australia is also participating in the EITI, and has other public and private initiatives on transparency, whistleblowing, and other anti-corruption matters. Standards Australia has issued guidelines on corporate governance, fraud prevention, and the like. ICAC and ASIC provide channels for reporting of violations and mechanisms for offending organizations to agree to penalties and corrective action. Political financing abuses and foreign bribery continue to be areas of concern, and government has made commitments to continue its efforts to strengthen controls and enforcement.

Recommendations

1) Support integrity pacts in such areas as campaign finance and outbound foreign investment.
2) Support development of private sector standards dealing explicitly with private sector corruption and related risk management and compliance issues.
3) Consider tightening the law on foreign bribery, including the prohibition of all facilitation payments.

B. Internal controls

This area is governed largely by voluntary controls, chiefly the ASX Corporate Governance Principles and Recommendations. The Principles provide benchmarks that listed companies under the authority of ASX must follow on a quasi-voluntary “comply or explain” basis. For other entities, the Principles provide a model that firms may consider in their internal governance. Internal audit is recommended by the Principles but not otherwise required, and is not formally organized as a profession although Australia does have a well-established association that is part of the IIA network. Audit committees are covered in detail in the Principles, and are mandatory for the largest category of listed firms by the ASX Listing Rules. Codes of conduct are also dealt with in some detail, and include such elements as “tone at the top,” company-wide commitments, reinforcement through training, and familiarizing agents and contractors with the code provisions. The Principles address risk management, stressing responses to the different kinds of risk, tailoring measures to company risk profiles, internal reporting, oversight by the audit committee, and annual review and adjustment. All of these internal control provisions must be addressed specifically in company disclosures to ASX.

Recommendations

1) Require ASX to provide detailed reports on company compliance with the Principles, including those on internal controls, to ICAC and parallel agencies as well as to officials responsible for monitoring compliance with UNCAC and the OECD Convention on Combating Bribery of Foreign Officials.
2) Alternatively, consider making internal audit, audit committees, and key internal control functions mandatory for every publicly-accountable business entity, including large non-listed companies. ASX could have authority to give waivers for alternative arrangements it finds to be adequate.

C. Integrity of financial statements

As in other areas, Australia largely adheres to best practice here. Record-keeping rules impose a 7-year retention period and prohibit falsification and improper destruction of records. Off-the-books transactions are covered by financial reporting standards and Corporations Act requirements, though not expressly outlawed. Financial reporting according to IFRS is required for listed companies and others above a threshold, and reports must include signed declarations by auditors, directors, CEOs and CFOs. There are lighter reporting requirements for SMEs, essentially companies that are not publicly accountable. All financial reports are to be audited according to ISA – the standards are mandatory for both audited entities and auditors themselves. Small companies are in some cases exempt or subject to simple review rather than audit. Reporting of fraud and corruption to company management is required, but not to the authorities – although auditors are required to report significant or unresolved violations of the Corporations Act to ASIC. Both statutory and professional bodies oversee accountancy and auditing practice, including education and licensing as well as quality control. ASIC supervises this area as well, and auditors are required to submit annual transparency reports to the agency and publish them on the web. Offenses in this area are often defined on a strict liability basis, while others are handled under the regulatory discretion of ASIC and ASX.

Recommendations

1) Consider an express prohibition on off-the-books transactions and other accounting manipulations associated with concealment of corruption.
2) Consider requiring auditors to report suspected corruption to the authorities, and providing a safe harbor provision protecting the auditors from liability.

Australia Laws, Regulations, Policy Documents Referenced:

Australian Securities and Investments Commission Act 2001, http://www.austlii.edu.au/au/legis/cth/consol_act/asaica2001529/.

ASX Corporate Governance Council (2010), *Corporate Governance Principles and Recommendations,* http://www.asx.com.au/documents/asx-compliance/cg_principles_recommendations_with_2010_amendments.pdf.

The Corporations Act, No. 50, 2001 as amended, http://www.comlaw.gov.au/Details/C2013C00605/Html/Volume_1.

NOTES

[1] All currency conversions are at interbank rate as of March 8, 2014, http://www.oanda.com/currency/converter/.

[2] http://www.icac.nsw.gov.au/education-and-events/information-for-the-community; ICAC (2004*), Developing a Statement of Business Ethics*, http://www.icac.nsw.gov.au/publications-and-resources.

[3] http://www.ccc.wa.gov.au/PREVENTIONANDEDUCATION/Pages/default.aspx.

[4] http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/australia/show-all.aspx; http://www.standards.org.au; OECD (2012), *Phase 3 Report on Implementing the OECD Anti-Bribery Convention in Australia*, OECD Working Group on Bribery, p.34.

[5] http://www.icac.nsw.gov.au/reporting-corruption/reporting-corruption-publications?view=search&task=doSearch&start=10#results. http://www.asic.gov.au/asic/asic.nsf/byheadline/Enforceable+Undertakings+Register?openDocument.

[6] The sources of all standards are provided in footnotes to the tables presented in the section of the Review entitled *International Standards for Country Reports.*

[7] http://www.asx.com.au/documents/asx-compliance/cg_principles_recommendations_with_2010_amendments.pdf.

[8] http://www.asx.com.au/regulation/corporate-governance-council.htm.

[9] AS 8001—2008, *Fraud and Corruption Control*, http://www.standards.org.au/.

[10] http://www.iia.org.au.

[11] Grant Thornton Australia, *2013 Annual Corporate Governance Report*, p.14, http://www.grantthornton.com.au/files/gtal_corporate_governance_2013.pdf.
[12] http://www.standards.org.au.
[13] The Corporations Act, No. 50, 2001 as amended, http://www.comlaw.gov.au/Details/C2013C00605/Html/Volume_1.
[14] Art.10 of the Act also sets non-consolidated revenue and asset thresholds of AUD 10 million (USD 9 million) and 5 million (USD 4.5 million) respectively.
[15] Australian Securities and Investments Commission Act 2001, http://www.austlii.edu.au/au/legis/cth/consol_act/asaica2001529/.
[16] http://www.ifrs.org/Use-around-the-world/Documents/Jurisdiction-profiles/Australia-IFRS-Profile.pdf; Action Plan Developed by the Institute of Chartered Accountants in Australia (ICAA), p.31, http://www.ifac.org/sites/default/files/compliance-assessment/part_3/201203ICAAustralia.pdf.
[17] OECD (2012: 33-34); ICAA Action Plan, p.19, http://www.ifac.org/sites/default/files/compliance-assessment/part_3/201203ICAAustralia.pdf
[18] ICAA Action Plan, p. 3, 11, 23, 27, http://www.ifac.org/sites/default/files/compliance-assessment/part_3/201203ICAAustralia.pdf
[19] Corporations Act, Schedule 3, arts.99-116ND.

Bangladesh

1. Introduction

In a challenging context of political polarization, poverty, and corruption, Bangladesh has made strenuous efforts to strengthen governance and raise living standards. Annual GDP growth from 2010 to 2012 exceeded 6%. Yet, 31.5% of the population lives below the poverty line and 76.5% were estimated as living on less than USD 2 per day in 2010. According to the Asian Development Bank, nearly 77% of employment and 43% of GDP are generated by the informal sector. Government still plays a major role in the economy, particularly in the financial sector. Bangladesh has one of the most liberal investment regimes in the region, yet reportedly faces difficulties in attracting foreign investment. A World Economic Forum survey found inadequate infrastructure and corruption to be the greatest perceived constraints to foreign companies operating in Bangladesh. In the same survey, business executives reported that the judiciary is not independent from political influences from government and business officials. A great strength and potential source of accountability in Bangladesh is civil society. The NGO sector is well known for innovation and activism, with such notable institutions as BRAC and Grameen Bank. The media are relatively open and robust. Yet both free expression and social action must contend periodically with government's hostility and attempts at control.[1]

In the past decade, Bangladesh adopted legislation to combat bribery, embezzlement, and money laundering, and to strengthen the Anti-Corruption Commission (ACC). The current Awami League government of Sheikh Hasina has publicly emphasized its commitment to combat corruption, but enforcement remains inconsistent. The prior interim government, in 2007, acceded to the United Nations Convention against Corruption. The same regime launched a campaign against corruption, resulting in the sentencing of numerous businesspeople, high-level political figures, and their family members by special anti-corruption courts. Accusations have since surfaced that the ACC was used for politically-motivated prosecutions. Many cases against leading Awami League politicians have been dismissed since the current government took office in early 2009. Public mistrust was reinforced in mid-2012 with the World Bank's decision to cancel a USD 1.2 billion loan to build the country's largest bridge, citing corruption concerns (a decision suspended and then confirmed the following year).[2]

Corruption of and by businesses (both private and public sector) is a significant problem, and includes asset-stripping, fraud, and bribery. Business-to-business corruption is not covered by Bangladesh's current anti-corruption legislation. Procurement reforms in 2006-7 aimed in part to stem corrupt practices in this area, but abuses continue. According to Global Integrity, conflict of interest regulations for procurement officials are not well enforced in practice, and there is no mechanism to monitor their assets or spending. Companies guilty of major violations including bribery are not always debarred from participating in future bids. Nevertheless, more than 50 companies were banned from the bidding process for violating procurement regulations between 2009 and 2010. Banking has also been the scene of numerous corruption scandals, some of them quite large, which have contributed to a heavy burden of non-performing loans. Two scams revealed in 2012 involved an estimated total of some BDT 70 billion (USD 890 million).[3] In one, an obscure corporate group took out a huge amount in loans from a single branch of Sonali Bank (a state-owned commercial bank) using fraudulent papers and inside connections.[4] Corruption also contributed to the catastrophic Rana Plaza building collapse in 2013. The abuses included issuance of safety compliance certificates to non-compliant factories and buildings, concealment of unsafe conditions, kickbacks paid from producers to buyers or agents based on inflated prices, and illicit payments for low-priced goods produced illegally in unregulated, sub-standard factories.[5]

Corporate governance has proven too weak to avoid such abuses. Most publicly-listed companies are family-run and prefer to keep ownership holdings within a small circle. Thus, a tight group of shareholders owns or controls the majority of shares, and steers company decision-making processes accordingly. Most independent directors reportedly represent current or former government officials. They are appointed in order to assist companies in getting licenses or as a reward for previous favors, and do not act as an advocate of majority shareholders or as a source of innovative ideas.[6]

2. General efforts to prevent corruption involving the private sector

Bangladesh has taken steps to improve communication and coordination for purposes of preventing and detecting private sector corruption. These have not always been successful or well-designed. Several pieces of legislation such as the Anti-Corruption Commission Act, 2004, provide for the protection of whistleblowers in the public sector. The Whistleblower Protection Act, 2011 has provisions for security and confidentiality of informants from any organizations, whether public or private sector.[7] The Voluntary Disclosure of Information Ordinance, 2008 provided for a Corruption Truth Commission, intended to give partial amnesties in return for information about corruption. However, the Commission was declared unconstitutional in 2011 by the Supreme Court, on the grounds that the basic law provided no authority for the granting of such amnesties. The ACC provides a channel for reports on public sector corruption by post and e-mail, and it now urges both state and non-governmental employees to report corruption offenses occurring in their organizations.[8]

Bangladeshi NGOs and associations have been active on governance and anti-corruption matters affecting the private sector. Transparency International Bangladesh (TIB) has led or supported a number of key institutional and policy changes, including the reform of the Anti-Corruption Commission, the ratification of UNCAC, and most recently, working with the Ministry of Law on the drafting of the Whistleblower Protection Act. The Bangladesh Enterprise Institute (BEI) advocates on policy issues of importance to the private sector. BEI convened the task force to draft the Code of Corporate Governance for Bangladesh. BEI is also part of a USAID-funded project with the ACC, the Office of the Comptroller and Auditor General, and partner ministries that aims to promote accountability, transparency, and responsiveness in order to reduce corruption.[9]

International standard[10]	Compliance by member country
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	Some efforts underway. Government leadership is less evident, especially under current regime, than is initiative by NGOs and private sector.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) Whistleblower Protection Act provides for confidential channel of communication for informants and complainants, including those from private sector. 2) Truth Commission to provide amnesty for those reporting corruption was struck down by judiciary.
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) ACC, BEI and others are cooperating in a US-funded project to strengthen transparency and reduce corruption. 2) Accounting profession governing body (ICAB), securities commission (SEC), TIB and others work to increase transparency and awareness of standards in private sector and professions. 3) Corporate Governance Code and related SEC guidelines provide guidance for companies (see below).
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	These do not appear to be used to any great extent. In public procurement, where they might be most effective, businesses found to have engaged in corruption are not uniformly debarred.

3. Internal controls

A. Internal audit

The Code of Corporate Governance for Bangladesh, 2004 (CCG) defines duties for companies in this area, stating certain standards as imperative and others that are purely advisory.[11] All listed companies must have an internal audit function. Private companies should consider establishing a system of internal controls if they do not have an internal audit department. The internal audit department should have a broad scope of work to investigate all levels of the company, be independent from management, and have direct access to the board of directors and audit committee. Directors must take adequate action to protect the company and shareholders based on internal audit reports. The internal audit department should have authority to access any records in any location at any time. Last, the internal audit function should have the authority to propose initiatives and changes directly to the board (CCG, p. 27, IV. Internal Audit). The Securities and Exchange Commission (SEC) issued a notification in 2012 applying Revised Corporate Governance Guidelines to listed companies. One of these guidelines requires the appointment of a Head of Internal Audit and recommends that this and other positions have clearly defined roles.[12]

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	Internal audit required for listed companies and recommended for others by Corporate Governance Code and SEC Notification.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect "illegal acts" in the books and records of companies, including bribery and other forms of corruption.	1) and 2) There appears to be no formal internal audit profession as such in Bangladesh. Internal auditors at different organizations use IIA/IPPF standards as guidelines.
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	1) through 3): Basic process and powers of internal audit defined in CCG. 4) Per CCG: Internal audit should be independent, report directly to the board and audit committee, and have broad authority to require documents and information. Directors must act on internal audit reports.

B. Audit committee

The Code of Corporate Governance (p. 15-16, X.) provides that companies with more than BDT 30 crore (USD 3.8 million) in turnover should have an audit committee composed of at least three members appointed by the board. The chair and a majority of members should be non-executive directors, and the chair should have a professional qualification and relevant financial experience (and not be the chair of the board of directors). Quarterly meetings are to be held to monitor internal and external audits. The committee should have terms of reference that include these responsibilities:

- Review the effectiveness of the company's internal risk controls and risk management systems;
- Monitor the integrity of financial statements and the clarity of disclosures;
- Review accounting policies, and any changes to them;
- Approve the appointment and removal of the internal auditor, review the internal audit reports and plans, ensure the internal auditor has the resources and support necessary to perform to a high standard, and meet with the internal auditor at least annually to discuss audit issues separately from management;
- Assess the independence and objectivity of external auditors, review their qualifications, monitor external audit resources and effectiveness, review and approve the annual audit plan, meet regularly with the external auditor to discuss audit issues, including at least once a year without management being present.

The SEC Notification of 2012 on Revised Corporate Governance Guidelines (art.3) imposes additional audit committee requirements on publicly-listed companies. Committee members must include at least one independent director, one with accounting or related financial experience, and all members must be "financially literate" (i.e. able to read and understand financial statements). No quorum of the committee exists without at least one independent director. Duties of the committee include, in addition to those listed above:

- Review annual and quarterly financial statements with management before submission to the board for approval;
- Review statement of significant related-party transactions submitted by the management;
- Review findings on internal control weaknesses issued by statutory auditors;
- Review quarterly and annual reports by company on the use of any funds raised by Initial Public Offering and similar means.

The audit committee reports on its activities to the board of directors, and this includes reporting immediately upon discovery of any conflicts of interests, indications of fraud or irregularities, material defects in the internal control system, and suspected infringement of laws and regulations. Where the committee reports such matters and the board fails to rectify them (after 3 reports or 6 months), the committee is to report the matters to the SEC. The audit committee must also report on its activities annually to the shareholders.

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	Per CCG and SEC Notification: 1) Audit committee required for listed companies, and recommended for non-listed companies above a size threshold. 2) Committee majority should be independent directors, and one member should have accounting/finance experience (mandatory for listed companies, with additional details).
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers, employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	Committee duties recommended per CCG, required per SEC Notification: 1) and 2): Accounting, internal and external audit, internal risk management oversight included, with more details for listed companies. 3) No requirement. 4) Listed companies: immediately report fraud or irregularity to board. If no board action, report to SEC. 5) No provision.

C. Internal control and compliance systems

Internal controls are mainly covered in the CCG. The SEC Notification (art.1.5) requires the directors' report to the shareholders to include a statement that the system of internal control is sound in design and has been effectively implemented and monitored – in addition to required oversight of internal controls such as that mentioned above.

The Code of Corporate Governance also calls for a statement about the effectiveness of internal controls by the chairman of the board, CEO, and CFO (p.26, II.D). The board should review and monitor risk management systems and internal control mechanisms to enable decision making and maintain the accuracy of financial results (p.12, II.F). The CCG also proposes that the board should establish a code of conduct detailing the directors' roles and responsibilities, and a corresponding code for management and employees (p.17-18, XII). The directors' code should be included in their orientations, and should be reviewed and confirmed annually. The code for management and employees should be signed and agreed as a condition of the contract of employment. The CCG also provides that a company should appoint a compliance officer to advise senior management and the board on their responsibilities with regard to legal and regulatory requirements, internal controls, and compliance with the Code of Corporate Governance (p.18, XIII). The officer should keep an annual record of the company's compliance/non-compliance with the CCG.

International standard	Compliance by member country
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors,	1) SEC Notification requires directors' report to shareholders to include statement about effectiveness of internal controls. CCG recommends. 2) Per CCG: Audit committee assesses and compliance officer advises on, internal control systems. 3) Per CCG: Directors' code of conduct given at orientation and renewed annually. Management and employee code should be part of employment contract. 4) No specific provisions on corruption.

officers, employees. 4) Risk-based approach: • Individualized assessment of risks to the enterprise, including corruption risks. • Regular monitoring and re-assessment of corruption risks.	
Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements. 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations. 4) Require for third-party representatives, consultants, or agents: • Written contract, adherence to company ethics standards and anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	1) and 2): Per SEC Notification, audit committee monitors legal compliance and indications of fraud, reports to board and to SEC as above. 3) Compliance officer may provide guidance, per CCG, but no specific provision on gifts, etc. 4) No provision.
Enforcement, including sanctions for failure to comply.	No provision.

4. Integrity of financial statements

A. Accounting

1. Financial records

The Companies Act (art.181) requires all companies to "keep proper books of account" recording all sums of money exchanged and for what purpose, all sales and purchases, assets, and production inputs as appropriate. The books must be sufficient to "give a true and fair view of the state of the affairs of the company and to explain its transactions." The books are to be accessible at the head office, and branch office accounts may be summarized in periodic returns to the registered office. Records are to be retained for 12 years, along with vouchers relevant to all entries. Failure to comply makes company officers and directors liable to fines and imprisonment. The SEC Notification of 2012 on Corporate Governance further requires directors of listed companies to include in their reports to shareholders a statement that proper books of account have been maintained (art.1.5).

International standard	Compliance by member country
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	Companies Act provides for form and method of record-keeping, with 12-year retention period.
Prohibitions (UNCAC 12(3), OECD Convention 8(1)), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	1) and 2): Falsification and destruction are generally prohibited by Companies Act provision. 3) through 6): Also generally covered under "proper" and "true and fair" standards of Companies Act, but not specifically prohibited.

2. *Financial reporting requirements*

All companies are required to present annually to the shareholders audited financial statements including balance sheet and profit and loss account (Companies Act art.183). Any company director who fails to take all reasonable steps to comply with this requirement is subject to fines. The Code of Corporate Governance (p.25-26, I-II) further advises that accounts should conform to accounting standards adopted by the Institute of Chartered Accountants of Bangladesh (ICAB) and be prepared by qualified personnel. Listed companies with turnover of at least BDT 20 crore (USD 2.5 million) must have the accounts done by a professional accountant with five years' experience or a CPA (or equivalent) qualification. The accounts should be reviewed and signed by the Chairman of the Board, CEO, CFO, and audit committee chair (if established), certifying the following:

- The accounts reflect a true and fair picture of the company's affairs and are in conformity with national accounting standards (or if not, material differences are disclosed);
- There are no off-balance sheet or omitted items (including post-balance sheet events) that are material or effect users' ability to evaluate the company;
- Assets are safeguarded against unauthorized use, and expenses are incurred for purposes of the company's business.

The SEC Notification of 2012 on Corporate Governance (art.1.5) reiterates these standards as requirements for listed companies.[13] The Notification (art.5) also requires audit committees of listed holding companies to review the financial statements of subsidiaries, in particular their investments.

ICAB is responsible for adopting and implementing IFRS as Bangladesh Financial Reporting Standards (BFRS). The process appears to be nearly complete, with full adoption currently planned for 2015. The BFRS for SMEs were published by ICAB in 2011 and match the IFRS for SMEs (2009 version) with a few modifications. Publicly listed companies must use BFRS, while others may choose between the BFRS and the SME version of the BFRS. The preceding IAS-based Bangladesh Accounting Standards are being phased out, but they may still be in use among non-listed companies during the transition to BFRS.[14]

International standard	Compliance by member country
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	Per Companies Act, CCG, and SEC Notification of 2012: 1) and 2): Listed companies must use IFRS/BFRS, while others may use BFRS for SMEs (or BAS). 3) All companies should include in the directors' financial report to shareholder a statement that there are no off-balance sheet items that would affect outsiders' ability to assess the company. Audit committee of listed holding company to review accounts of subsidiaries.
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) Disclosure required by IAS 37, applicable via BFRS, BFRS for SMEs, and BAS. Disclosure of possible impacts of corruption would normally not be required. 2) Covered by general norms in Companies Act, CCG, and SEC Notification of 2012 on true and fair accounts, but no specific prohibition.

B. Audit

1. Auditing requirements

Under the Companies Act (art.183), all corporations are to have their annual financial statements audited and present them to the shareholders with the auditor's report referenced or attached. The audited financials are to be signed on behalf of the board by the managing director (or equivalent) or alternatively by two directors (three in the case of banks) and filed with the Company Registrar (arts.189-190). If the AGM does not adopt the audited financial statements, this is to be noted on the documents with the reasons for it. Except in the case of private companies, the financial statements, auditor's report, and annexes must be sent to all shareholders and creditors (art.191). Banks and certain other financial sector companies must post their audited annual balance sheets and other information in prominent places in their registered offices and branches (art.192).

The powers and duties of external auditors are spelled out in the Companies Act (art.213). They have a right of access at all times to the books and accounts and vouchers of the company, and may demand from the officers of the company any information or explanations necessary for the audit. The auditor is to inquire about a number of matters concerning transactions that might be fraudulent or prejudicial to the company's interests, including loans, sales of securities, expenses, and book entries. The auditor is to provide an opinion on whether the accounts provide the information required by the Companies Act so as to give a true and fair view of the company's affairs. The audit report must also state whether the auditor has obtained all the required information and explanations from the company, whether proper books of account as required by law have been kept by the company and are in agreement with the financial statements, and the reasons for negative answers or qualifications.

The SEC Notification of 2012 on Corporate Governance (art.6) further requires the CEO and CFO of any listed company to certify to the board that they have reviewed the annual financial statements, and that the statements do not contain any materially untrue or misleading statement or omission, the statements present a true and fair view of the company's affairs and are in compliance with existing accounting standards and applicable laws, and no transactions were entered into by the company during the year which are fraudulent, illegal or in violation of the company's code of conduct. Companies are also required to obtain a certificate of compliance with the SEC's Corporate Governance Guidelines from a CPA or equivalent, and include this in the annual report (art.7).

In its capacity as the standard-setter for external audits, ICAB has adopted the ISA as Bangladesh Standards on Auditing (BSA), with limited modifications. ICAB has been carrying out this convergence since 1998, and continues to update its standards in line with changes in the ISA. It also provides training and continuing education to professionals in this area. [15]

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	Audits are required of all companies, and the standards are reasonably sound. Whether audits deter corruption is unclear, especially for smaller and private companies.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	1) All companies to perform annual audits of financial statements, and file audited financials with Registrar, per Companies Act. 2) No exception for SMEs. Private company filings are not open to the public.
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	ICAB has fully adopted ISA, including ISA/BSA 240, 250.
Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks. 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	Per Companies Act and SEC Notification, 2012: 1) Auditor to sign audit report, providing opinion on accuracy of financial statements, method of preparation. Auditor to inquire about illegality, fraud, other material risks. Testing of internal controls not included as such. Listed companies to obtain accountant certification of compliance with corporate governance guidelines. 2) Managing director or equivalent to sign accounts. Listed companies: CEO and CFO to sign and certify that accounts are accurate, no fraud or violation of law or code of conduct took place, etc. Auditor to have unfettered access to accounts and documents, and right to demand additional information and explanations. Audit report states to what extent company cooperated with the audit.

2. *Auditor reporting of improprieties*

Bangladesh does not provide outright for auditor reporting of illegality or corruption to the authorities. The BSA include ISA 240 and 250, which advise reporting to the company board and possibly going to the authorities, but there is no safe harbor provision to make the latter prospect realistic. We mentioned above the certifications about the absence of fraud, illegality, and material misstatement required of company directors, officers, and auditors by the Companies Act and the SEC Notification of 2012. These may make it more difficult to hide corruption, especially when coupled with the kinds of inquiries required of the auditor concerning potentially fraudulent or prejudicial transactions. But they do not mandate or safeguard whistle-blowing.

The Companies Act (arts.193-197) provides for other mechanisms to address financial reporting, fraud, or corruption. The Registrar is empowered to demand clarifications of the audited financials filed by companies, to follow up evidence of fraud in the financial statements, to seize documents, and to report findings to the government. In turn, the government may appoint inspectors to investigate the affairs of the company based on the Registrar's report. Investigators are also appointed on application by the holders of one-tenth of the company's shares (or 150 members of a non-share company). The government on its own motion or by court order can appoint an inspector if the circumstances warrant it, e.g. indications that company business is being conducted with intent to defraud or oppress stakeholders. The inspection mechanism thus provides multiple ways in which suspected fraud or corruption can be revealed to the authorities. Despite its potential utility and responsiveness to shareholders, it is not really a substitute for direct reporting to the authorities by the auditor.

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	Internal reporting required by ISA/BSA 240, 250, though corruption is not explicitly mentioned.
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").	1) No auditor on duty to report (beyond ISA 240, 250), but disclosures to shareholders and Registrar, and the government's power to investigate provide means to uncover fraud and corruption. 2) No explicit safe harbor provision.

C. Professional standards and independence

The Chartered Accountants Ordinance, 1961, provides for the governance of the accounting and auditing profession. It establishes the Institute of Chartered Accountants of Bangladesh as the governing and standard-setting body whose Council is empowered to implement the Ordinance. The Council's responsibilities include maintaining a register of chartered accountants, prescribing the qualifications and training required of professionals, issuing certificates to practice, regulating accountancy and audit practice, and exercising discipline over members (art.15). The Ordinance (art.21) also fixes penalties for unauthorized practice of the profession by non-members.

ICAB requires three levels of examination to enter the profession, as well as continuing education, including technical standards and ethics, which it administers. ICAB adopted the IESBA Code of Ethics, reviewing updated versions of the Code for adoption, and building awareness of the Code among members through educational programs. ICAB's Quality Assurance Board establishes and monitors standards for audit practice, issues practice guidelines, reviews audit working papers, and provides training. Quality assurance visits to audit firms were made mandatory in 2010. ICAB also has an Investigation and Disciplinary Committee to enforce standards. The Committee heard 29 cases in 2010-2011 (ICAB Action Plan, IFAC pp.3-24).

The Companies Act and SEC Notification of 2012 address the appointment of auditors and provide safeguards against conflicts of interest. The Act (arts.201-212) provides for annual appointment of auditors by the AGM, and requires reappointment of the incumbent unless the latter withdraws, is disqualified, or is removed by special resolution of the AGM. In the case of removal, the auditor has an opportunity to make written representations to the shareholders. Notice of all appointments, resignations, and removals must be provided to the Registrar. Only chartered accountants may serve as external auditors (firms may be appointed by name if all partners are chartered accountants). The following are not permitted to serve as auditors: directors, officers or employees, close business associates of the company or its officers, debtors or guarantors with obligations to the company of over BDT 1,000 (USD 13), or the company's managing agent (and partners, directors, or shareholders of the agent firm).

In the case of listed company audits, the SEC Notification (art.4) prohibits partners or employees of the audit firm from holding any share of the company during the tenure of their audit assignment. Listed companies may not hire their external auditors for such services as appraisals or valuations, financial information systems design and implementation, book-keeping or other accounting services, internal audit, brokerage or actuarial services.

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) Accountancy profession governed by ICAB under Chartered Accountants Ordinance. 2) ICAB has adopted IFAC/IESBA Code of Ethics.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	1) Companies Act regulates appointment and removal of auditors for all companies. 2) SEC Notification restricts non-audit work of listed company auditors. 3) No provision. 4) Companies Act restricts auditor interests in client firm, for all companies. 5) No restriction.
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) through 4): ICAB provides for qualification, licensing, training, ethical code, audit quality assurance, and discipline as authorized by Chartered Accountants Ordinance.

D. Enforcement

The Companies Act provides the main enforcement rules relating to accounts, financial reporting, and auditing. Those responsible for keeping proper books of accounts – managing agents or executive directors, or (if none exists) all directors – along with all officers of the company are liable for wilfully causing the company to violate the records provisions. Sanctions include imprisonment for six months and fines up to BDT 5,000 (USD 63) for each default (art.181). The same sanctions apply where the company fails to issue true and fair financial statements in the manner required, and the above persons failed to take all reasonable steps to comply (art.185). This reasonableness criterion applies in other situations as well. In case of default on the duties related to issuing audited financial statements and directors' reports, the penalty is just the BDT 5,000 (USD 63) fine. Where holding company financial statements fail to provide the necessary accounting details of subsidiaries, the above persons are liable to six months' imprisonment and fines up to BDT 1,000 (USD 13).

Similar penalties are prescribed in the following cases:

- Failure of CEO and CFO to certify accounts, attach audit report, or related default: six months' imprisonment and fine up to BDT 2,000 (USD 25) (art.189).
- Failure to cooperate with a government investigation concerning financial statements: imprisonment up to six months, fines up to BDT 5,000 (USD 63) and fines of BDT 500 (USD 6) for every day the default continues (art.200).
- Failure to cooperate with the external auditor: fines up to BDT 1,000 (USD 13) for company and all officers in default (arts.218-219).

The Chartered Accountants Ordinance (art.21) stipulates fines for persons engaged in professional accounting services who are not ICAB members and have no certificate. (The fines are denominated in rupees, presumably a holdover from the prior laws of Pakistan.) In either case, the fines on the books are startlingly low, especially in light of the prison terms accompanying many of them.

International standard	Compliance by member country
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2): It does not appear that the rules and procedures in this area are fully used to combat corruption.
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Companies Act sanctions include 6-month prison terms, which may have deterrent value, but fines are outdated and extremely low. 2) Some fines apply to companies, but are especially weak as corporate sanctions. 3) Government investigation procedures and ICAB disciplinary powers may be effective, though sanctions provided in the Act are weak.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Companies Act sanctions include 6-month prison terms, which may have deterrent value, but fines are outdated and extremely low. 2) Some fines apply to companies, but are especially weak as corporate sanctions. 3) Government investigation procedures and ICAB disciplinary powers may be effective, though sanctions provided in the Act are weak.

5. Conclusion and recommendations

A. General efforts to prevent corruption involving the private sector

Several anti-corruption initiatives are underway. Notable steps on the government side include strengthening the ACC and passing whistle-blower legislation protecting private and public sector informants. An arrangement to provide amnesty for self-reporting was voided as unconstitutional. Efforts from the private and civic sectors are also ongoing, and include some joint programs with government. NGOs have published investigative studies of corruption-related scandals such as the Rana Plaza disaster. The lead business association (BEI) coordinated the development of the corporate governance code. Integrity pacts – mechanisms to induce companies to join and jointly enforce anti-corruption pledges – do not appear to be used.

Recommendations

1) Revisit the effort to establish a structure for self-reporting of corruption offenses with authority to provide sentence-mitigation or amnesty.
2) Encourage and support the use of private sector and private-public integrity pacts.

B. Internal controls

Listed companies are required to have an internal audit function, while other companies are encouraged to do so and are given reasonable guidelines for this. There is no formally organized internal audit profession. Audit committee requirements are fairly robust, although only listed companies are legally required to maintain such a committee. Standards here are advisory for other companies, and highly recommended for firms above a size threshold. Audit committees in listed companies have reasonably strong independence and financial expertise standards, and are moreover required to report fraud and illegality to the board and in some cases to the SEC. Provisions on internal control mechanisms are largely advisory, though listed companies are required to address internal control in the annual report. The guidelines on internal control are well developed, calling for board supervision of internal controls, appointment of a compliance officer, and incorporation of code of conduct provisions in employment contracts. However, none of the above risk-management or oversight mechanisms is specifically tasked with addressing corruption vulnerabilities.

Recommendations

1) Support the development of an internal audit profession, and extend internal audit requirement to non-listed (especially public) companies.
2) Extend SEC audit committee requirements to non-listed public companies.
3) Make internal control procedures mandatory, phasing them in for listed and then all (or at least public) companies.
4) Incorporate explicit anti-corruption provisions in internal audit, audit committee, and internal control standards.

C. Integrity of financial statements

Bangladesh imposes a 12-year requirement on all companies for retention of accounting records. While this stringent requirement is in one sense laudable, it may impose an undue burden on private companies and SMEs. ICAB is in the latter stages of phasing in full IFRS and IFRS for SMEs, and has adopted the ISA. Requirements for audit reports, company certifications, and cooperation with the auditor are well developed and fairly strict. The blanket mandate that all companies should undergo annual external audit may prove burdensome to SMEs. While auditors are not specifically required to report irregularities to the authorities (nor protected in doing so), they are tasked with making inquiries about possible fraud in the accounts – and these findings are to be reflected in company certifications attached to the financial statements. In addition, the Registrar and in some cases government inspectors make inquiries or carry out investigations into possible fraud or other illegalities in company finances. The accounting and audit profession has a reasonably robust governance framework, with technical and ethical standards defined and disciplinary mechanisms in place. Restrictions on auditor appointments exist but do not include required rotation or restrictions on company hiring of former auditors. While ICAB and the SEC may provide effective oversight and discipline, the general enforcement provisions related to accounts and audit are the weakest link in the system – especially the outdated amounts fixed for fines. Nor are there specific provisions dealing with corruption.

Recommendations

1) Review and consider adjusting the burdens on SMEs of record-keeping and annual audits.
2) For government investigators of company finances, specify anti-corruption matters to pursue, and consider adding intra-private sector corruption to the ACC's mandate.
3) Tighten auditor appointment standards, at least for listed companies, to require periodic rotation and restrict company hiring of former auditors.
4) Consider adopting a requirement for auditors to report corruption and related irregularities directly to the authorities, along with a safe harbor provision protect them from liability.
5) Revise penalty provisions to increase fines to deterrent levels and allow adjustments for inflation.

Bangladesh Laws, Regulations, Policy Documents Referenced:

Anti-Corruption Commission Act, 2004
Companies Act, 1994 (Act No. 18 of 1994), http://www.boi.gov.bd/index.php/component/businesslaws/?view=lawdetails&law_id=32&task=law
Chartered Accountants Ordinance, 1961 (Ordinance No. X of 1961), http://bdlaws.minlaw.gov.bd/print_sections_all.php?id=306.
Code of Corporate Governance for Bangladesh, 2004.
Securities and Exchange Commission Notification, 07 August 2012, No. SEC/CMRRCD/2006-158/134/Admin/44 (Revised Corporate Governance Guidelines), http://www.secbd.org/Notification%20on%20CG-07.8.12-Amended.pdf.
Voluntary Disclosure of Information Ordinance, 2008.
Whistleblower Protection Act, 2011.

NOTES

[1] http://www.bti-project.org/reports/country-reports/aso/bgd; http://www.business-anti-corruption.com/country-profiles/south-asia/bangladesh/show-all.aspx.
[2] http://www.business-anti-corruption.com/country-profiles/south-asia/bangladesh/show-all.aspx. The government notes that cooperation with the World Bank continues despite this setback.
[3] All currency conversions are taken from http://www.oanda.com/currency/converter/ and based on inter-bank rate as of Feb. 12, 2014.

[4] http://www.bti-project.org/reports/country-reports/aso/bgd; http://www.business-anti-corruption.com/country-profiles/south-asia/bangladesh/show-all.aspx.

[5] Sadid Nure Mawla, Sharif Ahmed Chawdhury, and Nazmul Huda Mina (2013), *The Readymade Garment Sector: Governance Problems and Way Forward,* Transparency International-Bangladesh, http://www.ti-bangladesh.org/beta3/images/max_file/es_rmg_en_07112013.pdf. According to the government, the cause of the disaster may be attributed more to the deficiency of manpower for monitoring factory conditions. Government has therefore taken measures to increase manpower in the relevant authority.

[6] Rezwana Karim, James Bakul Sarkar and Rehana Fowzia (2010), "Corporate Governance Practices in Bangladesh with Reference to SEC Corporate Governance Guidelines," *ASA University Review*, Vol. 4 No. 2.

[7] http://bdlaws.minlaw.gov.bd/bangla_sections_detail.php?id=1072&sections_id=41350; government comments.

[8] http://www.business-anti-corruption.com/country-profiles/south-asia/bangladesh/show-all.aspx.

[9] http://www.business-anti-corruption.com/country-profiles/south-asia/bangladesh/show-all.aspx; http://www.bei-bd.org/policy-advocacy-details.php?adp_id=8.

[10] The sources of all standards are provided in footnotes to the tables presented in the ection of the Review entitled *International Standards for Country Reports.*

[11] The Code itself does not have legal force. Certain provisions or similar ones are incorporated in the Companies Act and an SEC Notification (see below).

[12] Notification, 07 August 2012, No. SEC/CMRRCD/2006-158/134/Admin/44 (Revised Corporate Governance Guidelines), art.2.1, http://www.secbd.org/Notification%20on%20CG-07.8.12-Amended.pdf.

[13] The requirements also appear in Rule 12 (2) of Bangladesh Securities and Exchange Rules, 1987: http://www.secbd.org/F-02.pdf.

[14] Action Plan Developed by ICAB, p.28, http://www.ifac.org/sites/default/files/compliance-assessment/part_3/201211BangladeshICAB.pdf; http://www.ifrs.org/Use-around-the-world/Documents/Jurisdiction-profiles/Bangladesh-IFRS-Profile.pdf.

[15] ICAB Action Plan, p.14-16, http://www.ifac.org/sites/default/files/compliance-assessment/part_3/201211BangladeshICAB.pdf.

Bhutan

1. Introduction

Bhutan has made significant advances in establishing a framework for transparency and preventing corruption involving the private sector. The last 15 years have seen a political transition to constitutional monarchy and judicial independence, although there remain constraints to freedom of expression and therefore political accountability.[1] The private sector is still comparatively small and dominated by a few companies and entrepreneurs, with a substantial presence of Indian firms, while state monopolies and bureaucratic procedures are viewed as obstacles to economic growth. The country has the second-highest per capita income in South Asia (USD 2,420)[2] and a reputation for relatively low corruption – but the low rate of literacy (52.8% in 2005) likely reduces accountability by both government and the private sector (BTI 2012: 15-17).

Corruption concerns seem to center on the construction industry, especially bidding for public tenders and procurements, and customs administration. Bhutan established its Anti-Corruption Commission (ACC) in December 2005. The Anti-Corruption Act was amended in 2011 to adjust penalties and bring in offenses such as money laundering, abuse of office, active and passive bribery in relation to public servants and the private sector.[3] As will be discussed below, the momentum of reform in Bhutan has begun to produce policies that create increased pressure for transparency and against corruption involving the private sector.

2. General efforts to prevent corruption involving the private sector

Bhutan takes limited measures to promote cooperation between law enforcement and private entities in preventing and detecting corruption. These do not include providing official channels or guidelines to companies for self-reporting of corruption. However, the law does require certain forms of disclosure, and preventive steps. A requirement to explain any adverse findings or qualifications in an audit[4] creates pressure to disclose irregularities as part of the company annual report. Corporate governance codes and internal controls are required specifically for public companies listed on the stock exchange.[5] In terms of promoting private sector cooperation with regulators, there is only *post facto* annual reporting to the Registrar of Companies and Royal Monetary Authority, and preventive internal controls as part of the corporate governance requirements for public companies (see below).

Bhutan takes part in some programs to promote integrity in the private sector. Workshops on corporate ethics and governance are currently conducted on an ad-hoc basis by the Registrar of Companies and the Central Bank when government approves budgets for them. They are not yet scheduled as annual events due to lack of continuing financial support by the state. More robust and continuing efforts in this area are desirable.

The Anti-Corruption Commission (ACC) is tasked with preventing corruption in the private sector in part by directing companies to adopt a code of conduct for good commercial practice and for proper contractual relations with government.[6] The ACC has developed and published on its website an integrity pact document for companies to commit to clean and transparent practices in government contracting. The integrity pact is being instituted by the Ministry of Finance under the procurement regulations, with the signed pact required to be submitted by bidders along with the tender documentation.[7] The ACC has also entered Memoranda of Understanding with business-related organizations such as the Bhutan Association of Women Entrepreneurs. These agreements aim to support the spread of information and training on integrity and combating corruption generally, but they do not address issues of corporate accounting, audit, or internal control. Nor have special efforts been made to extend the various above efforts to include small and medium-sized enterprises.

Druk Holding and Investments (DHI), the investment arm of the government, has also been working towards promoting good corporate governance in its portfolio companies (government controlled companies) by adopting internationally accepted standards and practices of good corporate governance. Thus, DHI launched its *Corporate Governance Code* in November 2013. Among other things, the Code provides model charters for boards and audit committees and a Code of Conduct to be adopted by its portfolio companies.[8] In addition, DHI has conducted trainings on corporate governance for the boards of directors of its companies, and awareness workshops on corporate governance for key stakeholders including members of parliament, government agencies, and the private sector.

International standard[9]	Compliance by member country
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	Limited measures to promote cooperation.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) The ACC has received self-reports from several companies.[10] 2) No mitigation provisions, but Corporate Governance (CG) Regulations and Companies Act promote internal controls and disclosure of improprieties.
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) Per AC Act, ACC is to help prevent corruption in the private sector by directing companies to adopt codes of conduct. 2) Workshops on corporate ethics and governance are currently conducted on an ad-hoc basis. Royal Audit Authority sets professional standards (see below). DHI provides training for its companies. 3) CG Regulations and DHI CG Code provide ethical principles for directors, officers, and employees to manage conflicts of interest, avoid misuse of position, etc.
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	The ACC has published an integrity pact document for companies to commit to clean and transparent practices in government contracting. The ACC has also entered memoranda of understanding with business-related organizations to disseminate information and training on integrity and combating corruption.

3. Internal Controls, Ethics, and Compliance

A. Internal audit

In Bhutan, there is no general legal requirement of an internal audit function (for example, a rule applicable to all public companies).[11] Audit standards contained in the Companies Act, the Corporate Governance Regulations, and the Financial Institutions Act, 1992 deal with matters of external audit. However, DHI's CG Code (art 2.4.10) requires each company it owns to establish an internal audit unit. The unit is to conduct regular reviews of the effectiveness of governance, risk management, and internal control systems and processes, and report directly to the board or the audit committee of the board. Terms of reference for the internal audit function are provided in the Audit Committee Charter of DHI's CG Code (Annex 2, Annexure 1).

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	Internal audit not generally required, not developed as a separate function. DHI's CG Code requires its companies to establish internal audit units.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect "illegal acts" in the books and records of companies, including bribery and other forms of corruption.	1) and 2): No professional standards established.
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	1) through 4): No general legal requirements. These elements are Included in internal audit TOR provided by DHI CG Code.

B. Audit committee

The Corporate Governance Regulations require the establishment of an audit committee by listed companies and financial institutions. Of the committee's three members, two must be independent directors, including the chair. Financial institutions have some further requirements. The Financial Institutions Act and the Prudential Regulations, 2002, issued by the Royal Monetary Authority require each financial institution to have an audit committee with at least three members, including a director, appointed by shareholders. The committee is to oversee financial reporting, internal controls and internal audit, external audit and legal compliance.[12] Survey responses indicate that audit committees are seen as necessary for good corporate governance but their members usually lack professional expertise. Moreover, in practice, internal auditors report to the audit committees, but the committees do not interact with external auditors**.**

The committee's duties, per the Corporate Governance Regulations, include the following:

- Establish appropriate accounting procedures, supervise compliance, and, as appropriate, commission audits.
- Approve and monitor the internal auditing strategy and procedures.
- Hire the company's independent external auditors (subject to ratification by the RMA), determine the scope of the audit, and assess the auditor's independence and remedy any conflicts of interest.
- Discuss the financial statements with management and the external auditor, and report to the board of directors, monitor and report to the board on management's efforts to correct deficiencies noted in an audit or regulatory examination.

It is also worth highlighting that the audit committees of financial institutions have the duty of informing the RMA of any fraudulent acts, irregularities, or deficiencies in administration or operations that should be expected to result in a material loss for the company or subsidiary.

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	1) Per CG Regulations, audit committee is mandatory for listed companies and financial institutions. DHI's CG Code requires its companies to establish audit committees. 2) Per CG Regulations: of the committee's three members, two must be independent directors.
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers, employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	Per CG Regulations, committee responsibilities are to: 1) Establish accounting procedures and commissions audits, oversee internal audit, and hire and monitor external auditors. 2) Monitor and report to the board of directors on management's efforts to correct deficiencies noted in audits and inspections. 3) No provision on this. 4) and 5): Inform the RMA of any fraud or irregularity that should be expected to result in a material loss.

C. Internal control and compliance systems

In Bhutan, internal systems of control and compliance are required of listed companies and financial institutions under the Corporate Governance Regulations enforced by RMA. These provisions (art.5 and Schedule I) describe the Board of Directors' responsibility to approve policies for oversight by senior management of subordinate staff and for reporting relationships within the company, and to promote the highest standards of corporate governance and integrity.[13]The DHI Corporate Governance Code (art.2.4) applies similar rules to government-controlled or –financed companies. A code of corporate governance for private and unlisted companies is slated to be developed in the near future (after amendment of the present Companies Act). Also, as mentioned, the Anti-Corruption Act (art.37) calls for the ACC to address private sector corruption by directing companies to develop standards and procedures including a code of conduct for the proper conduct of business.[14]

Under the CG Regulations (Schedule I, art.2), a company board is required to adopt and oversee enforcement of a code of ethics for the company that includes the following elements. A set of ethical principles is elaborated that calls for directors, officers, and employees to manage conflicts of interest, avoid misuse of position, prevent misuse of information, and ensure completeness and accuracy of relevant records. The principles also deal with accounting records.

The Regulations require each company board of directors (public and financial companies) to promote ethical behavior. This must include encouraging company employees to talk to supervisors when an ethical issue arises, and encouraging directors and employees to report violations of laws, regulations, or the company code of ethics to the chairman of the company governance committee (also a requirement). The latter must keep confidential the source of information concerning those violations. Further, the Board must ensure that reported violations of laws, regulations or codes of ethics will be investigated and disciplinary action will be taken as appropriate. Possible sanctions, such as suspension, dismissal, and referral to legal authorities are also described. Financial institutions are additionally required to have special risk management committees to address the range of risks affecting that sector, as well as to monitor compliance with laws and regulations.[15]

For companies in manufacturing, mining, and other industries (including non-public companies), audit reports must address whether the company's system of screening commission agents is adequate where sales are handled this way, and whether commissions are consistent with industry standards (Companies Act, Schedule XIV).

Importantly, internal control issues play a role in the accountability of companies for corruption. The Penal Code (ch.34) imposes criminal liability on companies where an offense (including bribery and embezzlement) results from the company's failure to discharge affirmative legal duties, or from the acts of senior management on behalf of the company, or where the company "failed to create and maintain a corporate culture that required compliance with the relevant law."[16]

International standard	Compliance by member country
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees. 4) Risk-based approach: • Individualized assessment of risks to the enterprise, including corruption risks. • Regular monitoring and re-assessment of corruption risks.	1) Per CG Regulations, internal control and compliance systems required of listed companies and financial institutions, and overseen by RMA. DHI CG Code applies internal control and ethics rules to government-controlled companies, requires disclosure. 2) No requirement. 3) Per CG Regulations: Board of Directors (listed and financial companies) required to adopt and enforce a code of ethics for the company, promoting the highest standards of corporate governance and integrity. Board also to set policies for senior management oversight of subordinate staff, and for reporting relationships within the company. 4) CG Regulations: No requirement. DHI CG Code: risk-based approach required.
Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements. 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations. 4) Require for third-party representatives, consultants, or agents: • Written contract, adherence to	1) Per CG Regulations: Boards of directors (public and financial companies) and risk management committees (financial institutions) must ensure compliance with laws, regulations, and corporate codes – and to back this up with sanctions. 2) No requirement. 3) No requirement. 4) Per Companies Act: Companies in relevant sectors (e.g. mining and manufactures) must address screening of agents in audit reports.

company ethics standards and anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	
Enforcement, including sanctions for failure to comply.	Per Penal Code: Companies are criminally liable when an offense is due to: • Company's failure to discharge affirmative legal duties. • Acts of senior management acting on behalf of the company. • Company's failure to maintain a corporate culture of compliance with relevant laws.

4. Integrity of Financial Statements

A. Accounting

1. Financial records

Tax regulations require all registered companies and business units to maintain proper accounting records. These should include Profit and Loss accounts, General Ledger, Bank Statements, and Journal. Small and micro business units have lighter requirements.[17] They must maintain basic accounting records to ensure that all transactions are recorded (e.g. cashbook, daily list of sales, purchase invoices).[18] Section 67(1) of the Companies Act, 2000 requires all companies to keep proper books of account with regard to money received and expensed, purchases and sales, assets and liabilities. Further, section 67 (5) mandates that companies preserve these books of account for a period of not less than five years immediately following the current year, together with the vouchers relevant to any entry in such books of account.

Schedule I, para 6 of the Corporate Governance Regulation, 2011 requires listed companies and financial institutions to maintain clear, accurate and complete accounting records and reports to reflect their true state of affairs and financial position. Entries that are false or misleading, or would obscure the nature of a transaction, are prohibited. No records, including financial statements, may be accessed and used except for the purpose approved by management – a rule designed to prevent manipulation. These rules are also to be incorporated into company ethics codes. Further, the Financial Services Act (arts.91-93) makes it clear that accounting records must be sufficient to enable the RMA to determine whether the institution has complied with the Act and regulations.[19] The records must be reproducible in legible form when required, and must be kept for at least ten years (with plans to preserve them in case of disaster).

International standard	Compliance by member country
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	Maintenance of proper accounting records required of all businesses. Retention for 5-10 years.
Prohibitions (UNCAC 12(3), OECD Convention 8(1), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	1) Listed and financial companies: no entries that are false or misleading, or that obscure transactions; no financial records to be accessed except for purpose approved by management. 2) All companies: records to be kept for 5 years. Listed and financial companies: 10 years, in reproducible form protected from hazards. 3) through 6): No explicit provisions, though above requirement of no entries that obscure transactions would cover.

2. Financial reporting requirements

Until very recently, there were no national accounting standards in Bhutan. The Accounting Standards Rules for Companies in Bhutan were issued in 2012. The Rules mandate the application of Bhutan Accounting Standards (BAS), which have been developed to comply with International Financial Reporting Standards (IFRS), from January, 1 2013. Full adoption of IFRS is expected to be completed by 2021. Bhutanese Accounting Standards for Small and Medium Enterprises were also authorized for implementation from January 1, 2014. The Accounting and Auditing Standards Board of Bhutan (AASB) has a plan to work towards establishment of a Professional Accountancy Organization in Bhutan.[20]

Under the pre-existing system set up under the Companies Act, corporations must use Generally Accepted Accounting Principles (GAAP) including accrual accounting to provide “a true and fair view of the state of the affairs" (art.67). The accounts must disclose every material feature, including credits or receipts and debits or expenses for non-recurring or exceptional transactions (Companies Act,Schedule XIII). Further, listed companies are required to issue a press release about any "material event that is not generally known and, if known, would be likely to have a significant influence on the market price of securities" (Corporate Governance Regulations, Section .14) .

Since empanelled firms from India provide most accounting and auditing services in Bhutan, GAAP was usually interpreted to mean Indian accounting standards. This situation is changing as the GAAP framework is being replaced by IFRS in the form of the Bhutanese Accounting Standards, along with the IFRS for SMEs for non-public small and medium companies.[21]

International standard	Compliance by member country
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) Phased adoption of IFRS (as BAS) is proceeding. 2) BAS for SMCs (IFRS for SMEs) authorized for adoption. 3) When BAS (IFRS) are fully implemented, such disclosures will be required.
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) Disclosure of material contingent liabilities required per Corporate Governance Regulations and IAS 37. Corrupt acts and their results would normally not be reported. 2) No express prohibition, but false or obscuring entries in financial records prohibited.

B. Audit

1. Auditing requirements

The Companies Act (arts.57, 75, Schedule XIV) requires audits of all registered companies, whether large or small, listed or not. The standards provide for a basic audit process, including review of financial statements, and analyzing the effectiveness with which assets are controlled, income is accounted for and expenditure is recorded. Every auditor of a company has the right of access at all times to the books of accounts and records of the company, and may demand any necessary information or explanations from the officers of the company. The report must provide the auditor's opinion as to whether the accounts provide a "true and fair view" of the state of the company's affairs and movement of cash (Companies Act art.74). Audits are to be conducted in accordance with "Generally Accepted Auditing Standards."[22]In practice, all statutory audits are performed by Indian accounting firms applying Indian Audit Standards (standards prescribed by ICAI), which are said to be broadly in line with ISA (World Bank 2009: 21).

Auditors (independently of the board and audit committee) are to assess the strengths and weaknesses of the accounting/internal controls system and frame recommendations to improve it.[23] The process also includes "proprietary audit," which should examine such matters as the effective use of company funds, and irregularities including excessive or unnecessary expenditure, embezzlement, misuse of property, and whether transactions comply with government regulations. Companies must include in their report of accounts to the shareholders explanatory information on every qualification or adverse remark contained in the auditor's report. The report must be signed by the chairman of the board (Companies Act, art.71, 75, and Schedule XIV).The Registrar of Companies conducts regular inspections to ensure that companies have complied with the Companies Act, including the requirements with respect to accounting and auditing (World Bank 2009: 18).The Financial Services Act (arts.95-104) provides additional requirements for that sector. Financial institutions and their directors and controllers are responsible for supplying complete information to the auditor, and ensuring that it is not false or misleading. Audited accounts are to be published in a newspaper.

Thus, in principle, Bhutan has a reasonably complete set of basic audit standards. The practice, however, is different. Indian auditors and audit standards are said to be less concerned with accounts providing a fair representation of companies' financial position than would be expected under Bhutan's laws or international standards. There is no requirement of actual testing of internal controls. Policing material misstatements and legal compliance is reportedly not done in practice. While public companies are required to perform external audits, they publish only very abbreviated accounts (survey responses).Further, the World Bank (World Bank 2009: 13-14) regards Schedule XIV of the Companies Act as prescribing a work plan for the statutory auditor that is "very wide and onerous" – including the range of proprietary, performance, and other audit components described above – without defining the reporting format and requirements. This scope of duties places the auditor's independence at risk by requiring "subjective reporting on a number of areas pertaining to the operation of the business" (World Bank 2009: 15).

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	May be sufficient in principle but not in practice.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	1) Per Companies Act: All registered companies required to conduct annual audits. 2) No modified standards for SMEs.
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	Per Companies Act: Audit process includes “proprietary audit” covering excessive or unnecessary expenditure, embezzlement, misuse of property, and compliance with government regulations.
Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks. 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	1) Per Companies Act: Auditor to state whether accounts provide a “true and fair view” of the state of the company's affairs and movement of cash. Auditors responsible for assessing strengths and weaknesses of the accounting/internal controls system and framing recommendations to improve it. 2) Chairman of board to sign report of accounts and certify that the accounts comply with standards. Per Companies Act, auditor has the right of access to accounts and records, and may demand any necessary information. Per Financial Services Act, institutions must ensure that information provided to auditor is not false or misleading, and publish audited accounts in a newspaper.

2. Auditor reporting of improprieties

The Companies Act (art.75, Sched. XIV) includes in the scope of an audit – and thus the auditor's report to the board and the shareholders/members – company compliance with applicable laws, rules and regulations, systems, and procedures. Thus, reporting of these matters – including corrupt practices– is required in all company audits. There is no requirement or allowance for direct reporting of these matters to external authorities except as described below, although reporting to members/ shareholders in addition to the board would in effect be public for publicly-held companies.

As for external reporting, auditors or audit committees dealing with listed companies, financial institutions, and firms with state participation or financing have a duty to report significant irregularities to the authorities. The Financial Services Act (art.103) requires an auditor to immediately report to the RMA any contravention of the Act, any offense "which relates to dishonesty or fraud," any losses incurred by the institution that reduce capital below prudential standards or jeopardize depositors, and any other "serious irregularity." The Corporate Governance Regulations (art.9) provide that a company's audit committee must inform the RMA of any fraudulent acts, irregularities, or deficiencies in administration or operations that "should be expected to result in a material loss" for the company or a subsidiary. Last, under the Bhutan Audit Act (art.48), the Auditor General has a duty to inform the Anti-Corruption Commission or other relevant authority if a state audit reveals suspected offences under the Act or other laws.

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	Per Companies Act: All company audits require reporting non-compliance with laws and regulations to the board and company members.
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").	1) Duty to report to RMA or ACC: • Financial Services Act: Fraud, serious irregularity, losses that reduce capital below prudential levels (FIs). • CG Regulations: Listed or financial company: irregularities likely to cause material loss. • Audit Act: State-supported company to report corruption offenses. 2) No explicit "safe harbor."

C. Professional standards and independence

Bhutan does not have an established accounting profession of its own. Until very recently, there was neither an established professional accountancy qualification nor any accountancy body or association to license statutory auditors or certify professional accountants in the country.[24] In 2010, with the assistance of the World Bank and ADB, Bhutan established the Accounting and Auditing Standards Board of Bhutan. It is charged with developing and issuing standards for accounting and auditing in line with International Financial Reporting Standards.

The Royal Audit Authority (RAA) is charged with monitoring accountants' and auditors' work, under art.75 and Schedule XIV of the Companies Act. Bhutan has embarked on framing a law for setting standards and establishing a regulatory body for accounting professionals. As of this writing, the law is still in draft stage and is being reviewed by the Accounting and Auditing Standards Board of Bhutan. This is a positive development, and Bhutan is to be commended for its initiative here.

Currently, since the accounting profession in Bhutan is made up largely of accountants from India (though the number of Bhutanese accountants is increasing), in practice the relevant standards are those of the Institute of Chartered Accountants of India (ICAI).[25] Accountants and auditors are legally required to adhere to professional standards (e.g. under the Companies Act and Corporate Governance Regulations), but there is no record of formal enforcement of such standards by either Indian or Bhutanese authorities.

As in the accounting field, Bhutan does not have its own established audit profession or auditors' association. Auditors are to be chosen from a panel maintained by the Royal Audit Authority (Companies Act arts.57, 72, 75, Schedule XIV). This empowers the RAA to monitor quality, independence, and professional conduct. Eligibility to be empanelled is defined in the Companies Act as well by RAA Terms and Conditions. In practice, all the 33 audit firms empanelled are members of the Institute of Chartered Accountants of India (ICAI) (World Bank 2009: 13). A further source of oversight is the RMA, as stipulated in the Financial Services Act (art.105). The RMA may at any time examine the books, other documents, accounts, and transactions of anyone who is or has been an auditor of a financial institution.

Auditors are appointed for one year, and usually hold their office for three consecutive financial years (the maximum allowed). An auditor can be removed before the expiry of the appointment only by special resolution of the general meeting, and the company must notify the Companies Registrar within 15 days (Companies Act arts.57, 72, 75). State control or financing brings a company under the Bhutan Audit Act (Art.39), providing for audit by the RAA.

The terms of RAA's empanelment prohibit accounting firms from providing other paid services (including preparation of accounts) once they have been appointed as the client company's statutory auditors – and from taking audit appointments if they have provided accounting or consulting services to the relevant company within the last two years. The RAA's standards require audit firms to ensure adherence to the professional code of conduct and ethical rules prescribed by their respective accountancy bodies. Since all currently empanelled firms are Indian, they need to comply with the code of ethics promulgated by the ICAI (although ICAI reportedly does not have jurisdiction beyond India). The RAA has no way of monitoring compliance with such requirements, though it does possess the power to refuse empanelment and to remove an audit firm from its panel (World Bank 2009: 15-17).

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) Professional accounting body, AASB, founded 2010 to develop standards. 2) No law or code for accountants as yet, but these are being developed. Accountants in Bhutan are mainly Indian (though number of Bhutanese is rising), but no record of enforcing Indian standards.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	Per Companies Act: 1) Appointment from RAA panel of eligible firms. 2) Statutory auditor's non-audit work for audited firm prohibited. 3) Rotation after 3 years, with shareholder approval and notice to Companies Registrar. 4) and 5): No restrictions.
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) Empanelment and oversight by Royal Audit Authority. 2) No requirements reported. 3) and 4): Empanelment and oversight by Royal Audit Authority. Supervision of financial institution audits by RMA. Oversight in principle by ICAI.

D. Enforcement

The enforcement provisions for record-keeping are the clearest in this area. Under the Financial Services Act (art.94), destroying, concealing, mutilating, or improperly altering any record or account required to be kept under the Act (or regulations) is considered a felony. Improperly sending records out of the country (an action likely to obstruct audit and enforcement) is also a crime. The Bhutan Tax Law 2001 (art.32) imposes a fine ranging from BTN 1,000 to 100,000 (USD15.70 to USD 15,700) – depending on the size of the business – for failure to maintain books of accounts and related documents as required by regulation. In addition, the Bhutan Penal Code (arts.300-301) treats tampering with accounting records, financial statements, and related documents as a misdemeanor. This includes mutilating, destroying, concealing, or falsifying such a document with intent to defraud or injure another person, or to conceal wrongdoing.

Other aspects of accounting and audit are addressed by means of professional sanctions and actions under company law. If an audit firm fails to report irregularities as required by law or fails to comply with the applicable requirements (e.g. Companies Act art. 75 and Schedule XIV), it is subject to disqualification for audit practice by the RAA. The Company Registrar, as well as the shareholders and directors of a company, may bring legal action in the courts for violations of accounting and audit provisions of the Companies Act (art. 141).

Bhutan's penalties for failure to comply with accounting requirements and standards have been quite limited. With the order requiring the implementation of BAS beginning in 2013, the government made violation of the standards a breach of the Companies Act.[26] However, the fine amounts listed in the Act (up to BTN 5,000 or USD 83 with small daily fines for continuing breaches, art.140) appear to be well below deterrent levels. However, they do apply to the companies themselves as well as to any individual managers, directors, and accountants directly involved in the violation of standards.

International standard	Compliance by member country
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2): Does not appear to be the case for accounting or auditing.

Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) and 2): • Per Tax Law: Fines ranging from USD 15 to USD 15,000 – depending on the size of the business – for failure to maintain books and accounting documents as required by regulation. • Per Penal Code: Tampering with accounting records, financial statements, and related documents is a misdemeanor. This includes acting with intent to defraud or injure another person, or to conceal wrongdoing. • Per Companies Act, failure to comply with BAS subject to fines up to USD 83 and small daily fines. • Per Financial Services Act: For FIs, destroying, concealing, mutilating, or improperly altering records or accounts legally required to be kept is a felony. 3) Company Registrar, shareholders, directors may bring action in court.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) through 3): If an audit firm fails to report irregularities as required by law to comply with the audit requirements of the Companies Act (art. 75, Schedule XIV), it can be penalized under companies Act (section 140) and is subject to disqualification for audit practice by the RAA.

5. Conclusion and Recommendations

A. General efforts to prevent corruption involving the private sector

Bhutan has made efforts to develop standards of ethics and good practice in the private sector. The ACC has taken an active role in bringing greater transparency and discipline to corporate governance, by such means as promoting integrity pacts and supporting workshops. DHI has also undertaken such activities for state-owned companies. In gene, the efforts to raise awareness and spread information in this area have tended to be partial and episodic, with little involvement by SMEs.

Recommendations

1) Conduct more widespread and regular workshops on private sector corruption, partnering the public with the private sector (especially SMEs) and the accounting and audit professions.
2) Enhance channels and incentives for self-reporting of corruption by the private sector through penal provisions on sentence-mitigation and outreach by the ACC.

B. Internal Controls, Ethics, and Compliance

In this area, there is a diverse mix of more- and less-developed elements. Except for DHI portfolio companies, there is no required internal audit function as such, nor is internal audit a recognized professional field. At the same time, there are reasonably developed rules on audit committees and aspects of internal control systems for public, financial, and state-owned companies.

Recommendations

1) Phase in required internal audit function, beginning with larger and listed companies, along with the relevant professional standards.
2) Require the disclosure of internal control and compliance systems (beyond the DHI companies, for whom it is required), along with assessment of these systems. Phase in a requirement of testing the control systems.
3) Adjust the internal control rules toward risk-based systems that explicitly prohibit, and support prevention of, corruption. This could be a phased initiative that begins with awareness and training, with voluntary guidelines, and moves toward legal requirements.

4) Require companies to provide guidance to staff on preventing corruption and dealing with activities that may become vehicles for corruption such as gift-giving and the use of agents.

C. Integrity of Financial Statements

An obvious concern in this field is Bhutan's lack of a strong professional sector of accountants and auditors. As Bhutan institutes the IFRS, it will need to make a significant push in the areas of dissemination and training, and in educating the core members of a Bhutanese accounting and audit profession. In parallel, it would make sense to reconsider standards and processes that may be unduly complicated, such as the corporate external audit template.

Realistically, it is impractical in the near term for Bhutan to create a home-grown sector of accounting and audit professionals. The critical point will be to provide clear local standards and guidance to the foreign-licensed professionals that do perform these functions, and to empower institutions such as RMA or AASBB to provide stronger enforcement. This is likely to require cooperation with sector authorities in India.

Bhutan's accounting standards call for comprehensive and accurate financial reporting, providing a partial definition of the required records and specifying the form and period for retention of records. The rules do not deal explicitly with such matters as off-the-books accounts, recording of non-existent expenditures, or use of false documents – though the standards can be reasonably interpreted to cover these matters**.** Financial reporting is undergoing a major upgrade with the implementation of IFRS-based standards. The equivalent process for audit standards is not as advanced. Sanctions for violations in the accounting and audit field appear woefully inadequate, while requirements and enabling rules for reporting corruption and fraud need to be strengthened.

Recommendations

1) Continue to develop accounting and audit standards, and the training and oversight of professionals. These, especially the latter, should be coordinated with the Government of India and ICAI, given the continued prominence of Indian accountants and auditors.
2) In the area of financial records, adopt explicit prohibitions of off-the-books accounts and transactions, and fraudulent entries.
3) In the area of auditing, move forward with adoption of International Standards of Audit. Revise the current standard scope for

company external audits, which is considered too broad and thus discourages careful and thorough audits.

4) Strengthen and make more uniform across types of companies and sectors the duty of auditors to report irregularities, including corruption, to external authorities. Create a legal "safe harbor" for such reporting.
5) In the area of enforcement, provide a more comprehensive array of explicit standards and sanctions, along with stiffer penalties, especially higher fines that are indexed to inflation. Maintain and publish statistics on enforcement actions in this field.

Bhutan Laws, Regulations, Policy Documents Referenced:

Accounting Standards Rules for Companies in Bhutan, 2012 (Ministry of Economic Affairs, Company Registry Division).

Anti-Corruption Act of Bhutan, 2011.

Audit Act of Bhutan, 2006.

Companies Act of the Kingdom of Bhutan, 2000.

Corporate Governance Regulations, 2011 (Royal Monetary Authority of Bhutan).

Cottage, Small and Medium Industry Policy of the Kingdom of Bhutan, 2012

Druk Holding and Investments, *Corporate Governance Code*, 2013, http://www.dhi.bt/index.php/media-room/publications.

Financial Services Act of Bhutan, 2011.

Income Tax Act of the Kingdom of Bhutan, 2001.

Penal Code of Bhutan, 2004.

Rules on the Income Tax Act of the Kingdom of Bhutan, 2001 (Ministry of Finance, 2005).

NOTES

[1] BTI (2012), "Bhutan Country Report," Bertelsmann Stiftung Transformation Index, www.bti-project.de/fileadmin/Inhalte/reports/2012/pdf/BTI%202012%20Bhutan.pdf, p.7-10.

[2] Atlas method, 2012 data, http://data.worldbank.org/indicator/NY.GNP.PCAP.CD.

[3] http://www.business-anti-corruption.com/country-profiles/south-asia/bhutan/snapshot.aspx

[4] Companies Act, sec.71.

[5] Corporate Governance (CG)Regulations, 2011, enforced by the Royal Monetary Authority (RMA, the central bank and de facto regulator of capital markets) under the Financial Services Act of Bhutan, 2011 (art.5 and Schedule I).

[6] Anti-Corruption Act, 2011, art.37.

[7] http://www.anti-corruption.org.bt/; government comments on draft report. Also the IFC has contributed to this field with its *SME Collective Action Toolkit in Bhutan.*
[8] http://www.dhi.bt/index.php/media-room/publications.
[9] The sources of all standards are provided in footnotes to the tables presented in the section of the Review entitled *International Standards for Country Reports.*
[10] Government comments.
[11] The government points out that internal audit functions are relevant to larger companies where there is a separation between ownership and management, but not to smaller companies where the owner is also the manager.
[12] World Bank (2009), "Bhutan Report on Observance of Standards and Codes: Accounting and Auditing," Report no. 49577-BT, p.18 **.** According to government comments, external auditors in practice report to managers only, so that observations are filtered. However, auditors are often required to attend the AGM, so that shareholders can question them directly.
[13] According to government comments, boards do not take an active role here in practice, tending to rely on the assurances of management and auditors
[14] Government comments point out that internal controls are very weak, in part due to the use of accounting and audit procedures based on Indian practice.
[15] Corporate Governance Regulations (Schedule I, arts.2, 9, and 11).
[16] According to government comments on a draft of this report, in some 65 cases (including 13 listed companies), the Company Registry has sought explanations or imposed penalties for non-compliance with statutory requirements of Companies Act or for financial irregularities reported by external auditors. Criminal sanctions were reported in one case, along with restitution amounting to some BTN 600,000 (USD 10,000).
[17] Small industries are defined as those with 5 to 19 employees, and investment of BTN 1 to 10 million (USD 16,600 to USD 166,000), Cottage, Small and Medium Industry Policy of the Kingdom of Bhutan, 2012.
[18] Rules on the Income Tax Act, General Provisions: Rule No.4.
[19] This refers to accounting records of the banking corporation, not records of client accounts.
[20] BBS, "Bhutanese Accounting Standards Launched," April 6, 2012, http://www.bbs.bt/news/?p=11478; Deloitte, "Accounting and Auditing Standards Board in Bhutan," July 28, 2010, http://www.iasplus.com/en/news/2010/July/news5804.According to government, the uptake of Bhutan Accounting Standards has been uneven. Audit Committees have not performed this role, probably because of the lack of skills
[21] World Bank (2009); http://www.ifrs.org/Use-around-the-world/Documents/Jurisdiction-profiles/Bhutan-IFRS-Profile.pdf. Government reports that IAS 37 is included in the first phase of adoption, and applies from 2013.
[22] Schedule XIV of the Companies Act sets out the basic standards and procedures. AASB is charged with developing Bhutanese Standards on Audit (BSA) reflecting the international standards (ISA).
[23] Government reports that, in practice, this is not usually done.
[24] As noted, establishment of a Professional Accountancy Organization of Bhutan is planned.

[25] Government reports that bachelor's degrees in accounting are usually obtained in India, but there are an increasing number of masters', which are mostly earned in Australia or Europe.

[26] http://www.aasbb.com.bt/Publish/News/1057034026207291136.pdf.

Cambodia

1. Introduction[1]

Cambodia has made great strides in governance reform and economic growth while struggling with a protracted transition process. The country continues to build a market economy, and has made significant progress since the 1990s. Globally, Cambodia ranks poorly in terms of its investment climate, but improvements have been made with regard to legal security and property rights. The establishment of a banking sector and capital market are core elements in the effort to reorganize the economy. There are currently 29 commercial banks, seven specialized banks and 27 licensed microfinance institutions active in Cambodia. In 2011, the Cambodia Stock Exchange was finally launched with the participation of the Korean Exchange, the initial listed companies being state-owned utilities. Growth rates have been impressive, averaging 8% from 2000 to 2013, even with the downturn due to the global financial crisis. Per capita GDP was estimated at USD 1,036[2] in 2013, and the poverty rate[3] at 18.9% in 2012. Reform to address the informal sector is at an early stage.

The democratization process begun under the guidance of the United Nations, which included Cambodia's first multi-party election in 1993, faces some difficulties. Cambodia is well-known for its active civil society, which ranges from grassroots activities to country-wide organizations. In 2011 and 2012, protests took place against forced evictions and large infrastructure projects, both in rural areas and in cities. The Government's Order No.1 on the New Action on Existing Policies for Land Sector has produced a significant increase in registered land titles. Further, economic growth has given the government a measure of legitimacy. Cambodia in 2010 adopted an anti-corruption law and established the National Council Against Corruption (NCAC) and the Anti-Corruption Unit (ACU), which have been active in enforcing the law against state officials, as reported by the ACU.

2. General efforts to prevent corruption involving the private sector

Cambodia's Anti-Corruption Law of 2010 provides for a two-tier system of authorities. The NCAC develops strategies and policies, and oversees the ACU. The latter has investigative duties and is charged with implementing components of the 2010 law such as the asset-declaration system. The unit develops the multi-year action plans and handles other practical anti-corruption duties, including the duty to "conduct mass education and awareness with regard to the negative impact of corruption and encourage public participation in preventing and combating corruption." The Unit also receives reports and complaints. The 2010 law implements articles of the Criminal Code that outlaw active and passive bribery of both domestic and foreign officials, and attempted bribery.[4] Sentence mitigation for self-reporting or preventive measures is not mentioned. The government in 2010 established an annual National Day Against Corruption. The ACU is charged with organizing the relevant events, with the aim of gaining support from the public, raising awareness of efforts to curb corruption, and educating about the negative effects of corruption.[5]

In terms of cooperation with the private sector, the government has made efforts to establish standards, promote business development, and provide feedback channels. Thus, for example, the Council for the Development of Cambodia (CDC) established a “Complaints Desk” for businesses to report on problems in dealing with regulations and administrative procedures such as delay, over-charging, and inadequate service. The CDC was established under the Law on Foreign Investment to serve as the government’s main investment promotion body, and is chaired by the Prime Minister.[6] The Securities and Exchange Commission of Cambodia (SECC) also provides a complaints page for companies dealing with the agency.[7] The SECC has in addition issued corporate governance standards – not as a voluntary code but an enforceable regulation (prakas) (see below).

In addition, Cambodia established the Government-Private Sector Forum (GPSF) in 1999. This is a public-private consultation held bi-annually under the chairmanship of the Prime Minister. The GPSF considers reports from its ten working groups and makes decisions that have the binding force of cabinet resolutions.

The ACU reports that it encourages companies to adopt internal ethics codes that prohibit staff involvement in corrupt practices, and to report any corruption to the ACU. The ACU has entered agreements with the private sector to cooperate in preventing corruption. In 2013, the ACU signed an MoU with a leading multinational company[8] in order to strengthen the collaboration between ACU and the company to fight corruption and build a culture of transparency within the company. The company agreed to take a proactive approach by keeping the ACU informed of any bribe solicitations that it may receive from government officials, suppliers, customers, and others. The ACU keeps these reports confidential.[9] The ACU is looking into cooperation with other companies as well. Private sector associations that have worked closely with the ACU include the Cambodian Chamber of Commerce, the Garment Manufacturers Association of Cambodia, the Cambodia Federation of Employers and Business Association, and the Federation of Associations of Small and Medium Enterprises of Cambodia.

Moreover, the ACU reports that it has conducted monitoring of various government procurement processes. This activity aims to enhance transparency in procurement bidding and thereby to encourage greater private sector trust, participation, and competition in the process.

International standard[10]	**Compliance by member country**
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	Government has outreach and cooperation initiatives with civic organizations and the private sector, a number of them dealing with private sector corruption.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) The ACU and CDC provide channels for reporting and complaints related to corruption and other administrative matters. 2) Incentives such as sentence mitigation do not appear to be available under the law.
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) Government has outreach activities on corruption, mainly handled by the ACU, which include private sector issues. The ACU reports that it monitors procurement processes, enters MOUs with companies, and collaborates with business associations. 2) and 3): The SECC has issued corporate governance standards for listed companies in a regulatory decree. For businesses more generally, there do not appear to be initiatives on ethical or corporate governance norms.
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	These do not appear to be used to any significant extent, although companies are encouraged to make pledges and enter compacts with the government.

3. Internal controls

A. Internal audit

Cambodia requires listed companies and financial institutions to have an internal audit function. The standards for listed companies are given in the SECC's prakas on Corporate Governance for Public Listed Enterprises (arts.37-39).[11] Each listed public enterprise is to have an internal audit unit that reports directly to the audit committee. The unit is primarily responsible for presenting a "balanced and understandable assessment" of the enterprise's performance; maintaining internal control systems to safeguard assets and shareholder interests; and carrying out internal audit investigations on the adequacy of governance and information systems, including compliance with laws and regulations. The unit is to report annually on its activities under the audit plans, addressing significant risk exposures, corporate governance issues, and control problems. The audit committee must ensure that the internal auditors have full access to all relevant information and records, and that internal audit activities are free from interference. The regulation also provides for the qualifications and responsibilities of the head of internal audit. The head must have auditing experience, knowledge of the field in which the company operates, and other qualities. The internal audit head must avoid activities leading to conflicts of interest, and must carry out duties assigned by the audit committee and meet with it once per year in the absence of senior corporate officers. The head must circulate audit reports to the committee and senior officers, and report significant findings to the committee.

There are some additional provisions in this area applicable to banking institutions, contained in regulations of the National Bank of Cambodia (NBC). The NBC Licensing Regulation[12] (arts.4-5) requires a bank license application to indicate the planned internal audit arrangements for compliance with the banking law provisions on internal control, and to provide this information as well for affiliate companies contributing 5% or more of capital. In addition, an NBC Circular[13] requires banks to have an internal audit department. The internal auditor should report to the highest management level practicable and be independent of company operating functions.

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	Listed companies and financial institutions required to have internal audit function meeting defined standards.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect "illegal acts" in the books and records of companies, including bribery and other forms of corruption.	1) Per SECC regulation: Basic education and audit experience requirements stipulated for internal audit head (listed companies). 2) Per SECC and NBC regulations: Internal auditor to monitor and report on legal compliance (listed and financial companies).
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	Per SECC and NBC regulations(listed and financial companies): 1) Internal audit covers financial reporting, asset control and performance. 2) Internal audit monitors risk management and internal control. 3) Legal compliance included. No explicit mention of fraud or corruption. 4) Internal audit unit reports to audit committee (listed companies) or highest management level (banks).

B. Audit committee

Audit committees are required for listed companies and financial institutions. Otherwise, the board of directors of a limited company is simply permitted by the Law on Commercial Enterprises[14] (art.131) to establish committees to facilitate its work. Committees are established by a majority of the board. Each committee must include one or more directors appointed by a majority of the board and has the rights granted to it by the written document creating it. No particular committees are specified. Further, the NBC Licensing Regulation (arts.4-5) requires a bank license application to indicate the composition and duties of its audit committee.

More specific requirements are applied to public listed companies by the SECC's prakas on Corporate Governance arts.32-33). Each such company must establish an audit committee having at least three (financially literate) members including one with financial expertise, and chaired by an independent director. The committee's tasks include reviewing financial statements, internal and external audits, and internal controls, as well as reporting the committee's activities to the board. Importantly, the Regulation establishes criteria for independent directors (arts.29-31). A director is not independent if she/he has been employed by the company or served as its auditor during the past year, has any contracts with the company or relationships with suppliers or NGOs receiving major donations from it, is a family member of anyone serving as a director or senior officer during the past year, or is a government official. An independent director may not have other interests or relationships that compromise her/his independence, and may not hold more than 1% of the company's shares.

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	1) Limited companies may, and listed companies and banks must, establish audit committees. 2) Per SECC Regulation: listed company audit committees must include a financial expert and be chaired by an independent director (meeting detailed independence criteria).
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers, employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	Duties of listed company audit committee, per SECC Regulation: 1) Supervise financial reporting, internal and external audit. 2) Review internal controls. 3) through 5): No provision.

C. Internal control and compliance systems

A number of legal-regulatory provisions touch on internal control matters. The Law on Commercial Enterprises (art.134) requires directors and officers to disclose to the company any material interests in a proposed contract or contracting party of the company. The SECC's prakas on Corporate Governance (arts.32-34) encourages all public listed companies to establish risk management committees, but requires it only of those with assets of KHR 200 billion (USD 50 million[15]) or above. The committee is to have three members including one with financial expertise. Its duties include the estimation, analysis, evaluation, monitoring, reporting, and management of risk. For companies that are not required to have a risk management committee, these tasks may be handled by the audit committee. In addition, the prakas (art.47) requires listed companies to disclose information on such matters as incentive policies, rules on conflicts of interest, and codes of conduct for directors and senior officers.

Internal controls are prescribed for banking institutions by the Law on Banking and Financial Institutions, 1999 (art.43). These companies are to establish internal control systems that perform the following functions:

- Verifying that operations, as well as organization and internal procedures, comply with laws and regulations, professional and ethical standards, and the policy set by senior management.
- Verifying that the limits laid down for risks, in particular counterparty, exchange rate, interest-rate and other market risks, are strictly observed.
- Monitoring the quality of accounting and financial information, in particular the methods for recording, preservation, and disclosure.

Further requirements are contained in the NBC Circular on Checks and Balances (№B7-05-02 CIR). The checks and balances, as part of the internal control system, should safeguard the accuracy of accounting records, enabling errors to be promptly highlighted and corrected. The minimum requirements here include segregation of staff duties – i.e. keeping separate the functions of recording, custody, and authorization for any specified banking operation – and avoiding conflict of interest situations when assigning tasks to staff.

International standard	Compliance by member country
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees. 4) Risk-based approach: • Individualized assessment of risks to the enterprise, including corruption risks. • Regular monitoring and re-assessment of corruption risks.	Per SECC Regulation and Banking Law: 1) Banks to have internal control systems, and listed companies above an asset threshold to have risk management committees. Public disclosure of ethics rules required of listed companies. 2) Banks to have controls on accounting and financial reporting, and to segregate staff duties. Large listed companies: this falls generally within risk management. 3) No requirement. 4) Controls to include and reflect assessment and management of risks.
Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements. 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations. 4) Require for third-party representatives, consultants, or agents: • Written contract, adherence to company ethics standards and	1) Per Banking Law: institution must have controls to ensure legal-regulatory compliance. 2) No explicit mention of corruption, but NBC and SECC standards on risk and compliance generally include it. 3) and 4): No provision.

anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	
Enforcement, including sanctions for failure to comply.	Regulators have authority to encourage or require compliance.

4. Integrity of financial statements

A. Accounting

1. Financial records

The Law on Corporate Accounts[16] (arts.3, 5, 12) requires all enterprises to keep books and accounts "[i]n compliance with current laws" and to have them audited in accordance with international standards as applied in Cambodia. All transactions are to be supported by documentary evidence. The financial statements and the corresponding ledgers and documentary evidence must be kept for at least ten years. The Law on Commercial Enterprises (arts.113-114) requires companies to maintain adequate accounting records for ten years, and to keep copies at the registered office if the originals are outside Cambodia. Each company is required to "take reasonable precautions to ensure that company books and records are maintained in an accurate and properly preserved condition." The Law (art.290) penalizes false entries in submissions to the Ministry of Commerce, but does not address manipulation of records specifically.

International standard	Compliance by member country
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	All enterprises to keep proper accounting records for 10 years, per Laws on Accounts and Enterprises.
Prohibitions (UNCAC 12(3), OECD Convention 8(1)), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	1) Per Law on Commercial Enterprises: false entries in submissions to Ministry prohibited. 2) Early destruction would violate retention rule of Laws on Accounts and Enterprises. 3) through 6): Not specifically prohibited, but generally not in compliance with record-keeping and financial reporting standards.[17]

2. Financial reporting requirements

All businesses must prepare financial statements. The Law on Corporate Accounts (arts.4-5, 8) requires enterprises to prepare annual financial statements in compliance with international standards as applied in Cambodia. The financial statements include the balance sheet, income statement, cash flow statement, and explanatory notes. The Law on Commercial Enterprises (arts.224-228) and related rules spell out companies' obligations in more detail. Directors are to present an annual financial statement to the shareholders at every AGM. The statements must provide comparative figures for the current and prior financial years, and include the auditor's report. Directors are to approve the financial statements, with at least one director signing, and then provide copies of the signed audited financial statement, audit report, and supporting documents to the shareholders. In the case of a public limited company with shares outstanding, a copy is to be sent to the Ministry of Commerce. Failure to comply with these requirements is subject to fines and imprisonment. Companies meeting a turnover threshold (KHR 30 million, approximately USD 750,000) must submit their audited financial statements (and audit reports) to the General Department of Taxation and the National Accounting Council.[18]

Financial Institutions are required to file their financial statements with NBC, and to publish them.[19] The World Bank noted in 2007 that the lack of a more comprehensive requirement for companies to file financial statements with a regulatory agency has seriously constrained the ability of potential investors to obtain information on companies.[20]

Cambodia's National Accounting Council (NAC) is the official standard-setting body under the Ministry of Economy and Finance. The Council has fully adopted IFRS and IFRS for SMEs without modifications, and these standards were made mandatory by a Ministry regulation of 2009. The Cambodian International Financial Reporting Standards (CIFRS) were made fully applicable as of accounting periods beginning in 2012. Mandatory implementation of IFRS/CIFRS for commercial banks and microfinance institutions was postponed until periods beginning in 2016.Otherwise, CIFRS are required for all publicly accountable entities including companies whose shares are publicly traded, financial institutions, and large entities. A company that is required to submit its financial statements for audit (under prakas No. 643 MEF/BK), but has no public accountability, must apply CIFRS for SMEs. Such an entity can also apply CIFRS if it deems this necessary. A company with no public accountability and no obligation to submit its financial statements for audit (per the above prakas) can also apply CIFRS for SMEs.[21]

International standard	**Compliance by member country**
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) and 2): Cambodia has fully adopted IFRS and IFRS for SMEs without modification. Publicly-traded and large entities must use IFRS, while SMEs are required to use IFRS for SMEs beyond a stated threshold. Application to financial institutions delayed to 2016. 3) Consolidated reporting required per IFRS 10.
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) Companies to disclose contingent liabilities per IAS 37, but this does not normally include prospective criminal liability for corruption. 2) No explicit prohibition, though such manipulation is generally inconsistent with IFRS.

B. Audit

1. Auditing requirements

The Law on Corporate Accounts (art.16) requires all enterprises to submit their accounts for audit by an independent auditor if they meet a Ministry of Economy and Finance (MEF) threshold based on turnover, balance sheet total, and/or number of employees. The auditor or firm must be drawn from an approved list kept by MEF. The Law on Commercial Enterprises (arts.229-230) requires a company to appoint an auditor for the financial year by ordinary resolution of the AGM. The shareholders of a company that has not issued securities to the public may adopt a resolution not to appoint an auditor. Thus, enterprises below a threshold and companies that do not issue shares to the public are not legally required to be audited.

The company and banking laws provide further rules for auditors' appointment and duties. The Enterprise Law (art.234) provides that the auditor must conduct a sufficient examination to permit her/him to report to the shareholders on the company's financial statements. Auditors have the right to participate in any shareholder meetings and to demand information, explanations, and access to any needed books and records from directors, officers, employees, or agents of the company – both present and former. The SECC prakas on Corporate Governance (arts.40, 43) provides that financial audits of listed companies are to be performed by auditors who are members of professional accounting firms accredited by the SECC and in each case nominated by the company board at the request of the audit committee. The auditor must "provide independent and realistic opinions on whether the financial statements truly and fairly represent the financial position and the operation" of the company in accordance with CIFRS. The audit must comply with Cambodian Standards on Auditing and Assurance.[22]

Under the Law on Banking (art.46), financial institutions must have external audits performed by auditors approved by NBC. Auditors are to certify the accounting statements, but only when satisfied of the fairness and truth of the annual accounting information reflected in the financial statements and supporting information. They are to report a summary of their findings to NBC, dealing with the entity's financial position, consolidation and valuation methods, payment of capital, and related-party transactions. The supervisor may request further information and explanations from the auditor. NBC regulations further specify the content of annual audit reports, including bank performance, regulatory compliance, and internal governance and control systems, in addition to the auditor's findings.[23]

Statutory audits in the private sector are to be conducted by the members of Kampuchea Institute of Certified Public Accountants and Auditors (KICPAA) (World Bank 2007: 5).The National Audit Authority audits all ministries, agencies, national banks, public financial institutions and public financial joint-ventures, public enterprises, sub-national public administrations, government contractors, and other organizations that have received financial assistance from the government, including tax and duty exemptions and concessions granted to non-profit organizations and private investment enterprises. This audit is focused on the compliance with the provisions, financial reporting audit, and audit on the operations.

The Ministry of Economy and Finance authorized the National Accounting Council to pursue the full adoption of the International Standards on Auditing (ISA) and related standards on quality control. The Ministry issued a prakas promulgating the Cambodian Standards on Auditing and Assurance, together with any updates needed to keep them current with the ISA.[24]

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	Auditing controls are reasonably developed, but it is unclear if they are sufficient for anti-corruption purposes.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	1) and 2): Per Laws on Accounts, Enterprises, and Banking: All enterprises above a threshold or issuing securities to the public must be audited annually by approved professionals. Banks must publish audited financials.
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	Cambodia has moved ahead with the full adoption and application of the ISA in Cambodia (See Prakas no. 370 MEF/BK).
Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks. 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	1) Per Banking Law, auditor to certify accuracy of financial statements, and audit reports to include reports on internal control. Per SECC Regulation, auditor to provide clear opinion on whether accounts are true and fair. 2) Per Law on Enterprises: Directors (not CEO/CFO) must sign audited financial statements before release. Auditors to have access to meetings, documents, and may demand information and explanations.

2. *Auditor reporting of improprieties*

The reporting of irregularities by external auditors is addressed as such only by the Banking Law (arts.46-47). Auditors must report to law enforcement if they discover that a financial institution has violated legal or regulatory provisions in a manner likely to harm the public interest. At the same time, an auditor or other person involved in administration of a financial institution has a duty of confidentiality with respect to any financial or administrative statements, documents, or information discovered in the course of her/his work. Failure to comply is subject to fines and imprisonment. A further provision of the article states that "the obligation of professional secrecy may not be used as a ground for nondisclosure vis-à-vis the supervisory authority, auditors, provisional administrators, liquidators, or a court dealing with criminal proceedings." Thus, the duty to report applies regardless of confidentiality, but legal protection of the person reporting is not explicitly provided.

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	Internal reporting would be required by ISA 240 and 250. All ISAs are fully applied in Cambodia (See Prakas no. 370 MEF/BK).
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").	1) Per Banking Law, auditors are required to report significant legal or regulatory non-compliance to law enforcement. Confidentiality does not excuse non-reporting. 2) No explicit safe harbor provision.

C. Professional standards and independence

The company and banking legislation contains limited provisions on auditor independence. Thus, the Law on Commercial Enterprises (art.232) in most cases permits removal of an auditor, or filling of an auditor vacancy, only by resolution of the AGM – i.e. the same mechanism as the original appointment. The SECC's prakas on Corporate Governance (arts.40-42) provides that a listed company's audit committee is responsible for the relationship between the company and the external auditor. In order to limit the risk of conflict of interest, any fees to be paid for audit and non-audit services must be approved in advance by the audit committee and disclosed in the annual report. A public listed company must rotate its audit firm every three years, with a three-year interval before any re-appointment of the firm.[25] The company may not obtain non-audit services from the firm such as internal audit, accounting, appraisal or valuation, or financial information system design. If an audit firm resigns or is dismissed, the audited company must report this immediately to the SECC and state it in the annual report, providing the reasons for it. NBC regulation also applies a three-year rotation rule to professional accounting firms providing bank audits.[26] The World Bank (2007: 11) found that the independence of auditors from the audited entities was not effectively practiced, and did not conform to international standards as issued by IFAC. The 2007 review also found that management tended not to take full responsibility for preparing financial statements but relied in part on the auditors.

The profession and its governance are at an early stage of development. The Law on Corporate Accounts (arts.14,17) provides for the formation of KICPAA as the governing body for accountants and auditors, under the authority of MEF. Professional accounting and audit practice may be carried out only by individuals or firms enrolled on KICPAA's list of professionals, and it is a conflict of interest for any civil servant, judge, or legislator to do so. KICPAA is responsible for on-going surveillance and enforcement of compliance with ISA and International Standards on Quality Control. KICPAA acknowledges having limited capacity to complete an evaluation of auditing firms in Cambodia, and so has been working with the World Bank and ADB on joint monitoring and evaluation with the goal of launching its own process. The actual market for audit services in Cambodia is relatively small due to low demand. There are 11 local audit firms and 38 foreign audit firms operating in Cambodia, including members of the large international accounting firm networks. Most banks, as well as large corporate entities, are audited by local members of international network firms. The local audit firms are small, mainly with one partner.[27]

KICPAA is responsible for licensing professional accountants and auditors, but in the absence of domestic training institutions, this essentially consists of approving practitioners with foreign qualifications. MEF issued a regulation in 2010 to the effect that only professional accountants of Cambodian nationality may undertake audit attestation services. For now, the foreign professionals who make up the majority of KICPAA may continue in practice. Given the need to expand the limited population of Cambodian professionals in the field, a local CPA program is being planned along with strengthened local university curricula in accounting. KICPAA is responsible for instituting investigation and disciplinary processes for its membership, but this has been hampered by lack of resources. The Institute has also been working towards the revision of laws related to the profession in order to enable Cambodia's adoption of the IFAC-IESBA Code of Ethics.[28] Government reports that Cambodia is an associate member of IFAC, and the Code of Ethics is in force.

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) Standards, training, and disciplinary systems under development. Accountants have foreign qualifications. 2) IFAC-IESBA Code has been partly adopted (see Sub-Decree No. 83 ANKR/BK dated 17 June 2005). KICPAA has become an associate member of IFAC.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	1) Per Law on Enterprises, appointment and removal are by AGM resolution. 2) No general rules, but SECC CG Regulation restricts non-audit services and requires disclosure – for public listed firms. 3) Per SECC and NBC rules: 3-year audit firm rotation. 4) and 5): Only general standard of avoiding conflict of interest. Per SECC Regulation: Audit committee supervises external audit, and committee is headed by independent director subject to safeguards. SECC also restricts hiring of former auditors.
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) Requirements are under development. Currently, auditors have foreign qualifications. 2) Standards and training under development. 3) KICPAA responsible for supervision, under MEF authority. Own capacity does not yet exist for oversight. 4) Disciplinary system under development. Capacity for enforcement appears weak.

D. Enforcement

Each of the major legal-regulatory instruments discussed above includes sanctions provisions. Thus, the Law on Corporate Accounts (arts.18-19) stipulates a fine of KHR five to ten million (USD 1,250 to USD 2,500) and imprisonment for up to two years for violations of the rules on proper bookkeeping and financial statements. The penalties apply to directors of companies that are in breach of the rules, and individuals are subject to revocation of professional licenses. Professional accountants and auditors who fail to comply with the Law are subject to fines of KHR ten to twenty million (USD 2,500 to USD 5,000). Repeat offenders are subject to double fines and imprisonment of one to three years. The World Bank (2007: 14) found that the Law did not provide a clear and effective mechanism for enforcing the corporate accounting, financial reporting, and auditing requirements – and that there was an absence of monitoring and enforcement activities with regard to applicable standards. This situation appears to be improving. Government reports that the National Accounting Council, KICPAA, and SECC are authorized to prosecute and penalize violations in their respective areas of competence.

The laws applicable to businesses provide sanctions for companies' (and in some cases the auditors') failure to comply. The Law on Commercial Enterprises (arts.290, 295-299) fixes fines of KHR one to ten million (USD 250 to USD 2,500) for entering false or misleading statements in materials filed with the Ministry of Commerce (this offense is also subject to imprisonment for up to six months), failure to keep proper books and records, and unjustified failure to send copies of financial statements to shareholders or the Ministry (this offense applies to companies).The SECC Regulation (arts.49-50) provides sanctions against listed companies in breach of the corporate governance standards. These include warnings, suspension or cancellation of registration, suspension or dismissal of directors, and fines of KHR five to 50 million (USD 1,250 to USD 12,500). The Law on Banking (art.55) stipulates fines of KHR one to five million (USD 250 to USD 1,250) and imprisonment for one to five years for obstructing an audit or examination, knowingly submitting false information to NBC, and failure (by the auditor) to report significant illegalities to law enforcement. Breach of confidentiality bears the same liability to imprisonment, but higher fines – KHR five to 250 million (USD 1,250 to USD 62,500).

International standard	Compliance by member country
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2): The legal-regulatory provisions on accounting and audit, although in some cases consistent with best practice, are not sufficient and not applied with enough rigor, for anti-corruption purposes.
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Sanctions include fines from USD 250 to USD 62,500 and imprisonment up to 5 years. Highest penalties apply to breach of confidentiality. 2) Some penalties apply to companies and/or their directors as well as individuals. 3) Effectiveness of enforcement has been questioned.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Sanctions include fines from USD 250 to USD 62,500 and imprisonment up to 5 years. Highest penalties apply to breach of confidentiality. 2) Some penalties apply to companies and/or their directors as well as individuals. 3) Effectiveness of enforcement has been questioned.

5. Conclusion and recommendations

A. General efforts to prevent corruption involving the private sector

Cambodia, addressing its problematic legacy of authoritarian politics and corruption, now has several kinds of initiatives that aim to improve governance in the public and private sectors. The NCAC and ACU lead the effort from the government side, with the former providing policy coordination and the latter a complaints channel, public awareness activities, and investigative functions. More focused on the private sector are the CDC and SECC, both of which aim to improve the business climate and provide complaint channels to businesses. The SECC, moreover, has issued corporate governance guidelines. While such efforts are encouraging, other methods including integrity pacts and incentives for self-reporting such as sentence-mitigation and are under-utilized. The ACU has concluded an MOU with a leading multinational company that could serve as a model for other public-private compacts to prevent corruption in business.

Recommendations

1) Extend feedback mechanisms and outreach efforts further into the private sector, mobilizing networks of small and micro enterprises to develop techniques to combat private sector corruption. Additional activities here could include integrity pacts in procurement and textile sectors, and development of business ethics codes.
2) Incentivize reporting of private sector corruption by improving complaint channels, sharpening public messages about corruption in the business-government nexus, and providing sentence-mitigation in return for preventive measures and self-reporting.

B. Internal controls

Cambodia has incorporated best practices in its internal control requirements for public listed companies (under the SECC Corporate Governance Regulation) and financial institutions (under the Banking Law). These entities are required to establish an internal audit function headed by an independent officer and reporting to the audit committee (top management in the case of banks). Internal audit oversees control systems, legal compliance, risk exposures, and accounting. Audit committees must meet regularly and have terms of reference. Listed company audit committees must be chaired by an independent director who qualifies according to reasonably strict standards of independence, and are charged with overseeing financial reporting, audit, and internal control. In terms of internal control and compliance systems, large listed companies must have risk management committees, while banks are required to establish controls that ensure legal compliance, verify adherence to risk-management norms, and monitor the quality of accounting and financial information. There are additional features such as segregation of duties (banks) and disclosure of internal ethics codes (large listed companies).

Recommendations

1) Consider extending the provisions of the SECC Regulation (on internal audit, audit committees, internal controls, and risk committees) to all publicly-accountable companies.
2) Include corruption-related criteria in the provisions on internal audit, audit committees, and especially internal control. Require internal audit to review compliance with norms on corruption risk, and have the audit committee provide guidance on preventing corruption and a confidential channel for reports of corruption. Include in internal controls company-wide written commitments to integrity, training on corruption prevention, guidance on risky areas such as gifts and the use of agents, and a clear statement that corruption is impermissible and must be prevented and detected.

C. Integrity of financial statements

Companies are required to keep books and records properly for ten years, and false entries and statements are penalized. Other accounting and record manipulations are not clearly defined in the current law. All companies are to prepare financial statements, but only large and publicly traded companies, and financial institutions (after a delay) must comply with IFRS (or IFRS for SMEs) as applied in Cambodia. Large and publicly-traded companies must have annual external audits. All auditors must be registered members of KICPAA, and auditors of listed companies and banks must be approved by SECC and NBC respectively. The audited financials are to be provided to the shareholders, the Ministry of Commerce, and in the case of banking firms, to NBC. Cambodia has adopted the ISA. The duty of an auditor to report irregularities exists only for audits of financial institutions, and this coexists with heavy penalties for breach of confidentiality – which do not excuse the failure to report when required. The capacity, professional oversight, and independence safeguards of auditors in Cambodia are all developing but still comparatively weak. The SECC Regulation provides the strongest safeguards for listed companies, with NBC providing similar protections. KICPAA's quality control and disciplinary capabilities are reported to be weak in practice. As for enforcement, a range of penalties applies to corporate officers, directors, accountants and auditors, and companies, with potentially serious fines and prison terms in some cases. But enforcement in practice is reported to be uneven.

Recommendations

1) Explicitly prohibit the full range of account and record manipulation methods known to be associated with concealment of corruption.
2) Consider expanding the application of IFRS/CIFRS, IFRS/CIFRS for SMEs, and mandatory audit in compliance with ISA for a wider population of companies including all public companies and others meeting a size threshold. Improve on IFRS by requiring disclosure of prospective liability for corruption offenses.
3) Expand the auditor duty to report irregularities to all public and large companies, and include the duty to report breaches of anti-corruption laws, whether clearly material to a company's financial position or not. Provide an explicit safe harbor rule to protect the auditor.
4) Expand application of SECC safeguards of auditor independence to cover all publicly-accountable companies. Reconsider the Cambodian nationality requirement for accounting and audit professionals, and invest in improving KICPAA capacity and partnerships with sister organizations abroad.
5) Improve enforcement across the board. Consider bringing enforcement and penalties more fully under independent state agencies including NBC and SECC. Create greater balance in penalties for breach of confidentiality as compared to other offenses such as falsification and failure to report corruption.

Cambodia Laws, Regulations, Policy Documents Referenced:

Law on Audit 2000 CS/RKM/0300/10, art.2, http://www.track.unodc.org/LegalLibrary/pages/LegalResources.aspx?country=Cambodia.

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Securities and Exchange Commission of Cambodia, *Prakas on Corporate Governance for Listed Public Enterprise*, 2010, 013/10 SECC, http://www.cambodiainvestment.gov.kh/content/uploads/2011/09/Prakas-013.10-on-Corporate-Governance-for-Listed-Public-Enterprise_101215.pdf.

NOTES

[1] http://www.bti-project.org/reports/country-reports/aso/khm/index.nc; comments by ACU.

[2] World Bank (Atlas method): USD 950 (http://data.worldbank.org/indicator/NY.GNP.PCAP.CD); Government of Cambodia: USD 1,036.

[3] Income per person of less that USS 2 per day, according to the Government of Cambodia.

[4] http://www.acu.gov.kh/en_index.php.

[5] ADB/OECD Anti-Corruption Initiative for Asia and the Pacific (2011), *Recent steps taken to implement the ADB/OECD Anti-Corruption Action Plan and United Nations Convention against Corruption (UNCAC): Country Reports*, p.32.

[6] http://www.cambodiainvestment.gov.kh/announcement-on-the-establishment-of-a-complaints-desk.html.

[7] http://www.secc.gov.kh/english/m43.php?pn=14 .

[8] The ACU identifies this MOU partner as the Coca-Cola Company.

[9] The ACU further reports that a “focal point” comprised of ACU officials has been established in order to coordinate with a counterpart “focal point” group representing the company, with the aim of working together on the implementation of the MOU.

[10] The sources of all standards are provided in footnotes to the tables presented in the section of the Review entitled *International Standards for Country Reports.*

[11] Securities and Exchange Commission of Cambodia, *Prakas on Corporate Governance for Listed Public Enterprise*, 2010, 013/10 SECC, http://www.cambodiainvestment.gov.kh/content/uploads/2011/09/Prakas-013.10-on-Corporate-Governance-for-Listed-Public-Enterprise_101215.pdf.According to questionnaire responses, some non-listed companies also maintain internal audit functions and internal control systems.

[12] NBC, *Prakas on The Licensing of Commercial Banks*, No B7-00-04 Pro Kor. Source for all financial sector laws and regulations: National Bank of Cambodia (2008), *Laws and Regulations Applicable to Banks and Financial Institutions*,

http://www.bot.or.th/Thai/EconomicConditions/AsianEconomies/cambodia/Info_Cambodia/DocLib_/Laws%20and%20Regulation.pdf.

[13] NBC, *Circular on Requirements for Bank and Financial Institutions to have a System of Checks and Balances*, №B7-05-02 CIR, 2005.

[14] http://www.cambodiainvestment.gov.kh/content/uploads/2012/03/Law-on-Commercial-Enterprises_English_050517.pdf

[15] Currency conversions are based on inter-bank rates as of April 15, 2014; http://www.oanda.com/currency/converter/.

[16] Law on Corporate Accounts, their Audit and the Accounting Profession, 2002, NS/RKM/0702/011, http://www.asianlii.org/kh/legis/laws/locataatap624/.

[17] Government survey responses indicate that all such practices are prohibited.

[18] As reported by government.

[19] Law on Banking and Financial Institutions, art.45.

[20] World Bank (2007), *Report on the Observance of Standards and Codes (ROSC): Cambodia – Accounting and Auditing,* pp.6-9, http://www.worldbank.org/ifa/Cambodia_aa.pdf.

[21] Announcement no. 097/09 MEF/NAC; government comments.

[22] Prakas No. 370 MEF/BK dated 18 May 2010.

[23] NBC, *Prakas on Annual Audit of Financial Statement of Banks and Financial Institutions,Guidelines on Items to Be Included*, 2004, №B7-04-204 Pro Kor.

[24] Action Plan Developed by Kampuchea Institute of Certified Public Accountants (KICPAA), p.8, http://www.ifac.org/sites/default/files/compliance-assessment/part_3/201211CambodiaKICPAA.pdf; Prakas No. 370 MEF/BK dated May 18, 2010 on the Promulgation of Cambodian Standards on Auditing and Assurance.

[25] Confirmed by SECC Proclamation No. 005. Government also reports that the SECC prohibits a company's hiring of a former auditor for a stated period of time.

[26] NBC Circular on the Selection of Independent Auditors by Banks and Financial Institutions, №B7-05-001 CL, 2005, art.3.

[27] KICPAA Action Plan, pp. 3-5; World Bank 2007: 9-10.

[28] KICPAA Action Plan, pp. 9-11.

P.R. China

1. Introduction

P.R. China's decades-long experience in coupling market forces with state-led development has yielded spectacular successes along with serious challenges. More than 30 years of economic growth at about 10% per annum has lifted standards of living and brought some 300 million people out of absolute poverty, transforming the country into a hub of innovation and placing it on a trajectory to become the world's largest economy in the years to come. Among the many challenges arising in the course of this development is the intertwining of market dynamics with state-party control and with older forms of social exchange.[1]

State enterprises are reported to account for about one-third of production and well over 80% of stock market capitalization in P.R. China. SOEs have undergone a series of reforms, including corporatization and a change from non-tradable to tradable shares, but analysts suggest that ownership is multilayered and the extent of ultimate state control not always clear. About 900 SOEs are listed, including some with shareholdings by collectives and local governments.[2]

Of special concern is the corruption that has grown and spread during P.R. China's economic transition. Since assuming office in 2013, President Xi Jinping has recognized the seriousness of the corruption problem for economic development and political stability, vowing to defeat its perpetrators, whether "tigers" or "flies" (high- or low-ranking officials). Several senior government officials have been charged with corruption and abuse of office. The Communist Party of China (CPC) has adopted successive Anti-Corruption Plans (2008-2012 and 2013-2017) and an official ethics code (2010). Criminal offenses include both active and passive corruption in the public sector, as well as extortion and money laundering, and (starting in 2011) bribery of officials of foreign governments and international public organizations.[3] An important part of the Chinese business culture is the establishment of close and long-lasting personal ties (*guanxi*), which in some contexts may encourage illicit favors and payments. Corruption is understood to be endemic not only in the public but in the private sector as well, and this despite penalties that, for the most serious offenses, include life imprisonment and the death penalty.[4]

Ample evidence has come to light in recent years of the substantial presence of corruption in P.R. China's business sector. Third parties, such as agents and distributors, are allegedly used to facilitate deals and are known to be used by companies to "outsource" bribery. Construction and real estate development offer major opportunities for corruption. No-bid contracts, nontransparent procedures, and massive corruption schemes involving contracting firms owned by local government officials result in low-quality construction. Yet, rules debarring companies involved in the violation of procurement regulations are reported to be strictly enforced. Land sales are the single largest source of income for local governments, and occasion further corruption to facilitate illegal acquisitions. The banking and pharmaceutical sectors have proven vulnerable as well, with investigations proceeding against companies, both domestic and foreign, operating in P.R. China.[5]

2. General efforts to prevent corruption involving the private sector

Government and the CPC have indicated great concern about corruption, as reflected in several policy initiatives. A 2010 cabinet white paper articulates policy on a range of corruption issues, including prevention of corruption in business, education of officials on anti-corruption matters, and public programs and ads about corruption.[6] A number of state and party structures are dedicated to combating corruption, although they have not taken the lead in investigations. The Central Committee for Discipline Inspection (CCDI) is responsible for combating corruption and ensuring integrity among Communist Party cadres. The National Bureau of Corruption Prevention (NBCP) was established in September 2007 with the aim of achieving compliance with UNCAC. The NBCP is intended to strengthen corruption prevention by analyzing the causes of corruption, assessing the corruption vulnerabilities of new policies, and guiding prevention activities in both the public and private sector. It does not investigate, but has focused on raising awareness and providing public information about cases.[7]

Regarding private sector efforts in this area, certain business sector initiatives appear to have the potential to develop and have an impact. For example, the China Business Leader Forum (CBLF) was established in 2005 as a result of collaboration between the International Business Leader Forum and Renmin University. The forum brings together foreign and Chinese business leaders to discuss how the private sector can improve business standards, including corruption prevention.[8]

International standard[9]	Compliance by member country
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	The picture appears to be one of strong government control, state campaigns of investigation and awareness-raising, and separate non-governmental initiatives that in some cases appear capable of developing and having an impact.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) No such mechanisms reported. 2) Active bribery is a crime, and private sector corruption has been prosecuted. Whether sentence mitigation is an option is unclear.
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) There are anti-corruption public awareness campaigns by state agencies, but partnerships do not appear to be used to any significant degree. 2) and 3): CBLF supports development of good business standards including corruption prevention. Professional ethics and corporate governance standards have developed significantly in recent years (see below).
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	These do not appear to be used to any great extent.

3. Internal controls

A few years ago, P.R. China adopted a major reform to strengthen listed companies' internal controls, and thereby to enhance the quality of their financial reporting. In 2008, the Basic Standard for Enterprise Internal Control was issued by the Ministry of Finance, National Audit Office, and three regulators of the capital and financial services markets.[10] The Basic Standard adapts key elements of the US Sarbanes-Oxley Act of 2002, and so is also known as "China SOX." Both listed companies and their subsidiaries are within the scope of the rule, but the treatment of cases at the margin is evolving with the rolling application of China SOX that began in 2011 (see below). Thus, foreign operating units of a Chinese company are in principle not within the scope of the Basic Standard, but they may be brought under it. Where the Chinese-listed entity does not have a controlling interest in an affiliate (as in a joint venture), it is unlikely that the latter will be considered within the scope. State enterprises under the

State-Owned Asset Supervisory and Administration Commission – the government body that exercises ownership rights in large and listed SOEs – are required to comply with the Basic Standard.[11]

A. Internal audit

P.R. China imposes no general legal requirement of internal audit on private enterprises. However, the Basic Standard (art.15) states that listed companies should[12] strengthen internal audit work to ensure that it is conducted in an independent and professional manner. Listed companies with state ownership must comply in the same way as other listed companies. In addition, the Audit Law requires state units subject to government audit, including SOEs, to establish an internal audit function.[13] Internal audit should include supervision and inspection of the effectiveness of internal control systems. When internal auditors find deficiencies in internal control, they must report these directly to the board of directors and the audit committee of the supervisory board (see below). More broadly, it is clear that internal audit is practiced to a significant extent in P.R. China. The China Institute of Internal Audit, a member organization of the IIA, works to strengthen the profession including by publishing Internal Audit Guidelines. Thus, for example, Guidelines 2301 and 2306 provide standards for organizing internal audit and ensuring quality control, while Guideline 2204 advises that internal auditors should check for occurrences of fraud – including bribery and other corrupt behavior – and report it to management or the board.[14]

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	Internal audit not legally required for private sector companies. There is a professional institute to promote the practice. Basic Standard: listed companies should have strong internal audit function.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect “illegal acts” in the books and records of companies, including bribery and other forms of corruption.	1) China Institute of Internal Audit organizes the profession and provides standards, which are not legally required, for internal audit. 2) CIIA Guidelines include duty to detect and report fraud and corruption.
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	1) CIIA Guidelines provide basic organization, procedure, quality control. 2) CIIA Guidelines and Basic Standard (for listed companies) provide for control systems audit. 3) CIIA Guidelines call for investigating and reporting fraud and corruption. 4) Internal auditor does not report exclusively to board or audit committee. Listed Companies under Basic Standard: internal auditor to report internal control concerns directly to board and audit committee.

B. Audit committee

The basic rules here are contained in the Companies Law,[15] which requires companies to establish a board of supervisors to perform functions similar to those of an audit committee. Limited liability companies and companies limited by shares must have boards with at least three members, or alternatively one or two members for a small company (arts.52, 118). Wholly state-owned companies must have supervisory boards with at least five members (art.71), while partially state-owned firms are treated the same as other companies. Board members must represent shareholders as well as officers and employees, but a director and a senior manager may not serve concurrently (art.52). A supervisor serves a term of three years, and is limited to two consecutive terms (art.53). The board must meet at least once per year (art.56), and once every six months for companies limited by shares (art.120).

The functions of the board of supervisors include the following (arts.54-55):

- to examine the financial affairs of the company;
- to supervise performance of duties by company directors and senior managers, to demand redress (or bring suit) when acts of the directors or senior managers damage the interests of the company, and to propose the removal of those who violate laws or rules adopted by the company;
- to investigate unusual circumstances in the company's operations as appropriate, hiring outside accountants if necessary.

Supervisors (as well as directors and senior managers) may not take loans from the company, whether directly or through a subsidiary, and their remuneration is to be regularly disclosed to the shareholders (arts.116-117).

In addition, the Basic Standard for Enterprise Internal Control (art.13) states that listed companies should[16] establish an audit committee under the board of directors. The committee is responsible for supervision and self-assessment of internal controls, coordination of internal control audit, and other related matters. (The Standard would thus result in listed companies having *both* a board of supervisors *and* an audit committee.)

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	1) Companies Law requires supervisory board. Basic Standard: listed companies should have audit committees. 2) No such requirement. Concurrent service by a director and senior manager prohibited.
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers. employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	Per Companies Law: 1) Supervisory board examines company finances. 2) Board also reviews compliance with company rules by directors and managers, investigating as appropriate. Listed companies under Basic Standard: audit committee supervises internal controls. 3) No provision. 4) Supervisors demand redress or removal, or bring lawsuit, in response to violation of laws or company rules by directors or senior managers. 5) No provision.

C. Internal control and compliance systems

After its promulgation, the Basic Standard for Enterprise Internal Control has been elaborated by further instruments and subject to phased implementation. The Supporting Guidelines for Internal Control of Enterprises, adopted in 2010, require listed companies to conduct and disclose annual self-evaluations and independent audits of the effectiveness of their internal controls. The Guidelines went into effect in January 2011 for the major SOEs and for companies concurrently listed in the domestic and overseas markets, and in January 2012 for companies listed on the main board of the Shanghai and Shenzhen Stock Exchanges. Companies listed on the specialized SME and “Growth Enterprise” markets are to adopt the Guidelines “when appropriate.” Non-listed large and medium-sized enterprises are simply encouraged to adopt the Guidelines.[17] All securities companies were earlier required to adopt internal control and risk management systems under the Securities Law.[18]

The Basic Standard requires the following major steps, in addition to the annual self-assessment and audit of internal controls:

- Include the five key elements required by international standards for internal control: control environment (consciousness by staff), risk assessment, control activities (policies and procedures), information and communication, and monitoring (art.5).
- Define and implement internal control policies, including documentation of internal controls, evaluation and adjustment (art.6).
- Establish an IT system with embedded controls to automate control processes in all areas of the business (for example, supply chain, customer service or financial reporting) (art.7).
- Adopt policies to incentivize the proper implementation of internal control, treating this as a key element of performance appraisals for managers and staff (art.8). [19]

There are a number of additional standards that provide for checks and implementation mechanisms. As mentioned above, the Basic Standard states that companies should maintain a strong internal audit function and set up an audit committee as part of the supervisory board (arts.13, 15). Companies must establish an anti-fraud mechanism that includes preventive, investigative, and punitive measures against fraud and corruption. This anti-fraud system should concern itself especially with such matters as embezzlement, misappropriation of corporate assets, and financial reporting offenses such as the use of false records and misleading statements or disclosures (art.42). In addition, companies under the Basic Standard must set up whistleblower mechanisms for fraud alert (art.43). Last, the Basic Standard places responsibility for the establishment of all internal control mechanisms upon the board of directors and supervisory board, with management seeing to daily operation of the controls (art.12).

In 2011, the first cohort of Chinese listed companies applying the Basic Standard and Guidelines included some 70 companies listed both in P.R. China and overseas, as well as more than 150 "pilot" listed companies. Self-assessments and audit reports were largely positive, but discussions with companies and investors suggested that the focus on achieving formal compliance compromised the underlying objective of the policy, i.e. to ensure that internal control frameworks are genuinely implemented and bring concrete benefits to companies. Reflecting this concern, the Ministry of Finance and the China Securities Regulatory Commission (CSRC) in 2012 announced an adjustment to the implementation schedule. Main-board listed companies were given three years to comply with the Basic Standard so that they could give full and proper attention to strengthening their internal control systems. However, this benefit was lost to some extent, since companies continued to press for full compliance in principle in order to avoid adverse audit findings.[20]

One area where it appears that internal controls need to be stronger is in the regulation of gift-giving. The tradition of giving gifts in red envelopes, whether cash or gift cards, is entrenched in the country, and is linked to the *guanxi* system of social networks mentioned previously. This gift-giving could be considered bribery in many legal systems, and has crossed the line into illicit behavior in some notorious cases. For example, a real estate company was found to have kept a list of government officials who were given amounts ranging from RMB 1,000 (USD 165[21]) to RMB 3,000 (USD 490) to facilitate registrations, licenses, and other official acts. In response, the government adopted regulations prohibiting gift cards. Chinese news media initially expressed doubt about the effectiveness of enforcement, since gift-giving is deeply-rooted in Chinese business culture.[22] More recently, however, new regulations along with publicity and sanctions against officials violating the rules have reinforced the change in policy.[23]

International standard	Compliance by member country
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees. 4) Risk-based approach: • Individualized assessment of risks to the enterprise, including corruption risks. • Regular monitoring and re-assessment of corruption risks.	Listed companies, per Basic Standard: 1) Adopt internal controls (also applies to securities firms per Securities Law). Disclosure of controls and assessment reports required. 2) Annual self-assessment report and external audit of internal controls, including on financial reporting. 3) Control environment element includes company-wide support and control-consciousness, incentives for compliance in staff performance evaluations. 4) Risk assessment required, including for fraud and corruption.

Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements. 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations. 4) Require for third-party representatives, consultants, or agents: • Written contract, adherence to company ethics standards and anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	Per Basic Standard: 1) Adherence to laws and standards, accuracy of financial reports included in key internal control elements. 2) System must deal with fraud and corruption, and include whistleblower mechanism. 3) Should be included in Basic Standard, but no explicit requirement. Government has adopted separate regulations on giving and receiving of gift cards, applicable to officials of government and SOEs. 4) Should be included but no explicit requirement.
Enforcement, including sanctions for failure to comply.	No specific provisions for enforcement reported.

4. Integrity of financial statements

A. Accounting

1. Financial records

Several legislative provisions deal with record-keeping. Under the Accounting Law,[24] accounting books, statements, and data must conform to the rules of uniform state accounting systems. Forgery, alteration, or submission of false accounting statements is prohibited. Electronic records must conform to State Council and Ministry of Finance provisions (art.10). Vouchers, account books, reports, and other accounting data should be filed and kept in accordance with rules set by the state. Retention periods and methods of destruction are to be decided by the financial department of the State Council jointly with the departments concerned (art.15). Corporate officers or staff who prepare false accounting vouchers; change or intentionally destroy vouchers, accounting books, statements, or related information; or use such false accounting documents or information against public interests are subject to investigation and punishment under administrative and criminal laws (art.26). As in some other systems, the fixing of specific time periods and penalties is left for separate enactments.

Further provisions appear in corporate and securities legislation. A company is not permitted to have any other accounting books in addition to the statutory accounting books (Companies Law art. 172). If a company creates false records or conceals important facts in documents such as financial reports submitted to government agencies, the responsible persons are subject to fines (art.203). Under the Securities Law (art.147), a securities company must keep proper records of client accounts, trades, trusts, internal management, and business operations. The records are to be kept for 20 years, and may not be concealed, altered, or damaged.

International standard	Compliance by member country
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	Record-keeping provisions in Accounting, Companies, and Securities Laws deal with manner of retention, though the time period is defined elsewhere in most cases.
Prohibitions (UNCAC 12(3), OECD Convention 8(1)), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	1) Creation or use of false documents prohibited in Accounting, Companies, Securities Laws. 2) Intentional early destruction prohibited by Accounting and Securities Laws. 3) Companies Law: only one, statutory, set of books permitted. 4) through 6): Generally covered by Accounting Law provisions, but no specific prohibition.

2. Financial reporting requirements

All Chinese companies must produce annual financial statements (Companies Law, arts. 63, 165). The Accounting Regulatory Department of the Ministry of Finance (MOF) is responsible for setting accounting standards. Those standards, Chinese Accounting Standards for Business Enterprises (ASBE), were originally issued in February 2006 and recognized by IASB as substantially converged with IFRS. A Roadmap issued by the Ministry in 2010 foresees that the ASBE will be revised and improved as needed over time, in order to continue convergence with IFRS. According to the Accounting Law (art.14), all Chinese companies (including SOEs) must comply with the standards issued by the Ministry of Finance; the ASBE are part of the regulatory system and have the force of law. P.R. China has not adopted the IFRS for SMEs. Instead, the MOF in 2011 issued the Chinese Accounting Standard for Small Entities, which were developed using IFRS for SMEs as a key reference.[25] If a small enterprise is a subsidiary, and if its parent company follows ASBE, then the particular small enterprise is also required to comply with ASBE.[26]

Full compliance with the financial reporting standards has been subject to a phased schedule. Different jurisdictions in P.R. China are reported to have differing phase-in schedules with respect to companies' compliance with ASBE. For example, Shanghai-based companies are subject to the standards if they fall into one of the following sectors: manufacturing, construction, retail, wholesale, transportation, postal service, and hospitality/catering. Such companies must then assess the various size criteria to determine if they need to apply ASBE – i.e. number of staff, total revenues, and total assets. (In the construction sector, a firm must comply if it exceeds the ranges set for any one of the criteria or if it falls within the ranges: staff of 600-3,000, revenues approximately USD 5 million to USD 46 million, assets approximately USD 6 million to USD 61 million.[27]) The MOF has been weighing the cost/benefit as it adjusts the plan for full national compliance with ASBE. The staggered approach presents complications, such as entities within the same corporate group having different compliance timetables – although companies can request approval for early adoption on a voluntary basis (PWC 2011: 6-7). The compensating benefit, presumably, is to adapt compliance schedules to the level of readiness in different sectors and types of companies.

The Accounting Law (Chapter IV) requires each corporate entity to establish an internal accounting supervision system. This is to ensure that enterprises follow a systematic approach in maintaining books of account and preparing financial statements that provide a true and fair view of enterprises' financial performance. Top management is not allowed to influence accounting personnel unduly so as to manipulate measurement and disclosure of financial information. The Code of Corporate Governance for Listed Companies (art.25) requires such enterprises to establish sound accounting and financial management systems in accordance with applicable standards, and without interference from the controlling shareholders. The Securities Law requires listed companies to prepare both interim (quarterly and half-yearly) and annual financial statements and submit them to the CSRC. The annual financial statements must be audited and submitted to CRSC within four months of the end of the financial year (World Bank 2009: 4-5).

The Company Law (art.166) states that company management is responsible for ensuring timely preparation of annual financial statements reflecting a true and fair view of the entity's financial condition and operating results. Management is also responsible for submitting the corporation's audited financial statements to the general shareholders' meeting within four months of the end of the financial year. Failure to perform these responsibilities may lead to sanctions, including fines. Apart from listed companies, there is no statutory requirement for public interest entities to allow public access to their financial statements. The audited financial statements of listed companies and financial institutions must be published in a printed annual report, on the Internet, and in newspapers designated by the respective regulators. Noncompliance may lead to sanctions (World Bank 2009: 5).

International standard	Compliance by member country
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) Phased adoption of IFRS-converged standards (ASBE). 2) Chinese standards for small entities, loosely based on IFRS for SMEs. 3) Yes, per IFRS 10 equivalent.
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) IAS 37 equivalent covers this issue, but normally does not require disclosure of impact of possible corruption prosecution. 2) Generally covered by record-keeping and financial reporting provisions of Accounting and Company Laws, but no express prohibition.

B. Audit

1. Auditing requirements

The Company Law (arts. 63, 165) requires all companies, including any one-person company with limited liability, to have their annual financial statements audited by an accounting firm. This applies to state enterprises as well. If an SOE is wholly state-owned, it falls within the special provisions of the Companies Act (arts.65-71), but is otherwise treated as a normal company. The Audit Law (arts.20-21) provides that state institutions, headed by the National Audit Office, are to audit SOEs, and that the State Council is to provide further specifics on state audit of enterprises with controlling state ownership. Thus, under the Companies Act and Audit Law, companies with state ownership are subject to both external audit by professional auditors and to state audit. The Audit Law (art.30) provides that state auditors have the authority to check the private auditor's reports and part of their review.

The companies must comply with Chinese Auditing Standards, which are developed by the Chinese Institute of Certified Public Accountants (CICPA) based on the ISA. In late 2005, P.R. China signed a joint statement with the IAASB undertaking to incorporate ISAs in Chinese Auditing Standards and to maintain ongoing convergence with the ISA. In 2006, P.R. China released a set of auditing standards that were fully converged with ISAs. In 2009, P.R. China began to update Chinese Auditing Standards to achieve convergence with the whole set of clarified ISA, and this process was completed and the new standards released in late 2010.[28] The World Bank has assessed the Chinese Auditing Standards as being "largely comparable" to the ISA issued by the IAASB, but found that the level of compliance with the standards varied greatly across accounting firms (World Bank 2009: 14).

Financial institutions face additional requirements monitored by the China Banking Regulatory Commission. Auditors are required to conduct independent evaluations of the internal control and risk management systems of the banks, and the resulting evaluation reports are to be attached to the banks' annual reports. The statutory auditors are obliged to report to the CBRC on any significant noncompliance with applicable standards and codes, and any impact on the bank's sustainability (World Bank 2009: 7, 20).

In terms of audit procedure, the Companies Act (art.171) requires each company to provide authentic and complete accounting vouchers and books, financial and accounting reports, and other accounting data to the auditor. The Act prohibits corporate officers from refusing to cooperate, concealing facts, and making false reports. Neither certification of financial reports by the company nor certification of the audit opinion is expressly required. The Securities Law (art.173) imposes similar requirements on securities trading firms.

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	Required controls comply with international standards and apply to all companies, but appear to be implemented unevenly.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	1) Per Company Law, all companies must have financial statements audited by an accounting firm. 2) No special provision for SMEs.
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	Chinese standards are substantially converged with ISA, including 240 and 250.
Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks. 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	1) Company Law does not provide for certification or requirement of audit opinion. CBRC requires bank auditors to test internal control systems. Basic Standard requires external audit of listed company internal controls. 2) Company Law: Company officers must cooperate with auditor, provide accurate documents, not conceal or mislead. Certification not mentioned.

2. Auditor reporting of improprieties

Reporting by the auditor is covered by the Chinese Audit Standards incorporating ISA 240 and 250. These standards require internal reporting to management and the board of fraud or illegality. They do not in themselves provide a legal basis for reporting to external authorities on corruption or other irregularities. Moreover, the Law on Certified Public Accountants[29] (art.19) states the auditor's obligation of confidentiality regarding business information discovered in the course of the audit. However, as stated above, CBRC does require bank auditors to report non-compliance with standards. This requirement may be read to cover fraud and corruption, but it does not make express mention of them.

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	Internal reporting required by ISA 240, 250 equivalent.
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").	1) ISA 240, 250 equivalent provide for external reporting, but only if supported by legal requirement and/or safe harbor. CBRC requires bank auditors to report non-compliance with standards. No express provision on corruption. 2) No legal safe harbor. CPA Law requires confidentiality.

C. Professional standards and independence

The accountancy profession is supervised by the Ministry of Finance and managed by the Chinese Institute of Certified Public Accountants (CICPA). Audits can be done only by qualified accounting firms. The Law on Certified Public Accountants (arts.4-5) sets up the professional governance structure run by CICPA under state authority, and states the basic requirements for qualification as a CPA (Chapter II). The major functions of the CICPA, as defined in the CPA Law (Chapter V) and regulations, include regulating admission to the profession along with examinations, formulating professional standards and rules, administering professional development programs, enforcing professional standards and ethics code, and discipline. CICPA, a full member of IFAC, has more than 150,000 members and a Code of Ethics reported to be fully converged with IFAC/IESBA. The MOF and CSRC are responsible for registration and supervision of the accounting firms that provide audit services to listed companies. The two agencies require these accounting firms to meet specific conditions in terms of number of employees, years in business, and capital (World Bank 2009: 3-8; CICPA Action Plan 2013: 11).

The Ministry, the regulators, and CICPA each review financial reporting and supervise the quality of audits. The MOF Supervision and Inspection Bureau conducts reviews of company financial statements and practice reviews of accounting firms and CPAs. CICPA conducts audit practice reviews on a regular basis (cycles of three years), and has taken some punitive measures against auditors for noncompliance with standards. The CSRC reviews financial statements of listed companies for the purpose of monitoring and enforcement of standards, and reviews audit practices. The Shanghai and Shenzhen Stock Exchanges, in monitoring compliance with the listing rules, review financial statements filed by the listed companies. In the recent past, the stock exchange reviewers have identified manipulations of accounting estimates in various companies. As a result of capacity constraints, the stock exchanges find it difficult to conduct financial statement reviews and to follow up effectively, and their most common sanction for noncompliance is a warning letter. In addition, many of the non-listed entities, notably in the financial sector, have significant public interest, but their accounting and audit practices are not subject to strong monitoring and enforcement (World Bank 2009: 16-17).

In terms of auditors' appointment, tenure, and safeguards of independence, a number of legal and regulatory provisions apply. Under the Companies Law (art.170) a company's appointment and dismissal of an accounting firm in charge of external audit must be subject to decision by the shareholders or board of directors in accordance with the corporate charter (typically, the board decides). Also, the statutory regulators – MOF, CSRC, CBRC, CIRC – require notification and justification of any decision made to terminate an existing auditor. The MOF and CSRC require the engagement partner of a listed company auditor to be rotated every five years (WB 2009: 6). The CPA Law (art.18) requires a CPA to withdraw from an assignment if a conflict arises, and accords the client the right to demand such withdrawal. CPAs are not permitted to buy or sell shares, debentures, or property of an audited firm (for a period set by regulation), nor to work concurrently at more than one accounting firm or to provide debt-collection services (art.22).

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) CICPA governs qualification, training, discipline, etc. of CPAs with supervision by MOF. 2) CICPA has adopted an ethics code fully converged with IFAC/IESBA.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	Per CPA Law, Company Law, and regulations: 1) Audits to be conducted by accounting firms. Appointment and dismissal by AGM or board, with notice and justification to regulator. 2) Some restriction on non-audit work. 3) 5-year rotation of engagement partner for listed company audits. 4) Broad conflict of interest standard, requirement of auditor withdrawal. 5) No restriction.
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) and 2): Audit must be done by CPAs in accounting firms. CICPA governs qualification, training, ethics, discipline, etc. of CPAs with supervision by MOF. 3) MOF and state regulators supervise audit performance in addition to CICPA. 4) Sanctions primarily imposed by CICPA, though regulators also have authority.

D. Enforcement

There are enforcement provisions related to financial reporting and audit in the legislation governing this area.[30] Also, based on the discussion above, it appears that enforcement is uneven in many areas. According to the Companies Law (art.150), a director, supervisor, or senior manager who violates legal-regulatory norms or provisions of the company charter in such a way as to cause a loss is liable to compensate the damages. In such a case, the shareholders of a limited liability or company limited by shares holding 1% of shares (for 180 consecutive days) may request the supervisors (or supervisory board) to bring a lawsuit, and where a supervisor causes a loss in the same way, shareholders may request the board of directors or executive director to bring a lawsuit. The same shareholders may bring a suit in the interests of the company – a shareholder derivative suit – where the above company officers fail to bring suit (art.152).

Other provisions of the Companies Law fix fines for legal violations. Thus, if a company keeps accounting books other than the statutory ones, it is subject to fines up to RMB 500,000 (USD 82,000) (art.202). As mentioned above, if a company creates false records or conceals important facts in documents such as financial reports submitted to government agencies, the responsible persons are each subject to fines of up to RMB 300,000 (USD 49,000) (art.203).

The Securities Law (art.225) applies a similar provision. If a listed company, securities company, stock exchange, securities registration and clearing institution, or securities trading service institution fails to keep documents and materials according to the relevant provisions, and fails to correct the default, it is subject to fines up to RMB 300,000 (USD 49,000). Where documents are concealed, forged, altered or damaged, fines up to RMB 600,000 (USD 98,000) apply. Where violations are considered serious, the securities regulator may prohibit the person from entering the securities market (i.e. engaging in securities practice, holding a post of director, supervisor, or senior manager) for a defined term or for life (art.233).

International standard	Compliance by member country
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2): Accounting and audit rules are fairly robust, but it is not clear that they are fully used to combat corruption, based on sanctions provisions and information on enforcement in practice.
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Sanctions include fines up to USD 98,000, debarment from securities markets, shareholder and derivative suits. 2) Some penalties apply to companies, though most apply to directors, supervisors, and senior managers. 3) Enforcement is through administrators or courts at various levels of jurisdiction.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Sanctions include fines up to USD 98,000, debarment from securities markets, shareholder and derivative suits. 2) Some penalties apply to companies, though most apply to directors, supervisors, and senior managers. 3) Enforcement is through administrators or courts at various levels of jurisdiction.

5. Conclusion and recommendations

A. General efforts to prevent corruption involving the private sector

Anti-corruption efforts in P.R. China are characterized by strong government control, state campaigns of investigation and awareness-raising, and separate non-governmental initiatives that in some cases appear capable of developing and having an impact. State anti-corruption bodies such as NBCP articulate appropriate policies and messages. Mobilizing public-private cooperation to combat private sector corruption has not been a high priority. The laws make active bribery a crime, and private sector corruption has been prosecuted. The China Business Leader Forum appears to be a positive initiative led by the private sector to support development of good business standards including corruption prevention. Professional ethics and corporate governance standards have developed significantly in recent years. Integrity pacts do not appear to be used to any great extent, though the mechanism of pledging to high standards and self-policing by the private sector could be effective in the PRC.

Recommendations

1) Build closer cooperation between government and private sector on prevention and detection of corruption. This should include strong whistleblower protections, complaint mechanisms, and sentence mitigation provisions for self-reporting.
2) Encourage integrity pacts in the private sector, providing leeway for civic organizations and international NGOs to facilitate them.

B. Internal controls

P.R. China has taken an important step forward in this area by adopting the Basic Standard for Enterprise Internal Control, which adheres to best international practice, requiring listed companies to establish internal audit systems, audit committees, and internal control and risk management mechanisms. Otherwise, internal audit is not legally required for private sector companies, although it is practiced and a professional structure of standards and governance is provided by the China Institute of Internal Audit. The Companies Law requires corporations generally to maintain supervisory boards, which carry out some functions of an audit committee. Supervisors can demand redress or removal, or bring lawsuits, in response to violation of laws or company rules by directors or senior managers. Internal controls are not expressly required except for the companies under the Basic Standard and the Securities Law. Importantly, the Basic Standard requires annual self-assessment reports, disclosure of the reports, and external audit of internal controls, including on financial reporting. Internal controls must deal with illegalities, fraud, and corruption. Implementation of the Basic Standard is being phased in.

Recommendations

1) Develop an adapted version of the Basic Standard for SMEs and non-listed companies that have a dimension of public interest due to their size, structure (e.g. family-based conglomerate), or sector (e.g. finance).
2) Encourage, and consider requiring, all large and public companies to establish internal audit functions, audit committees (e.g. within the supervisory board), and internal control systems. Fix audit committee membership criteria, including a majority of independent non-executive directors and at least one expert in accountancy.
3) Require control systems, especially audit committees and internal control and risk management mechanisms, to provide guidance, adopt safeguards, and provide whistleblower channels for specific fraud and corruption risks. The latter include inappropriate gift-giving and bribery by means of third-party agents (in P.R. China or abroad).

C. Integrity of financial statements

P.R. China's laws on corporate governance and accounting prohibit various book-keeping manipulations that might be used to hide corruption. Convergence of Chinese financial reporting standards (ASBE) with IFRS has been achieved in the past, and efforts continue to be made to keep the standards up to date. The phase-in of ASBE application across sectors, company sizes and types, and regions of P.R. China enables a tailored approach but risks confusion and complication. Special norms apply to smaller firms, though these are only loosely based on IFRS for SMES. All companies, including non-public firms and SMEs, must conduct annual audits, and these are to apply Chinese Audit Standards that are substantially converged with the ISA. Audits are more rigorous for banks and companies under the Basic Standard than for other corporations. There appears to be no requirement to certify financial statements under any of the standards. Nor is there a safe harbor for auditor reporting of fraud and corruption to state authorities. There are reported to be serious capacity constraints that limit enforcement of accounting, auditing, and related corporate governance rules by regulators and other state authorities. CICPA seems to perform more consistently in policing CPAs and accounting and audit practice. Legal safeguards against audit interference and conflict of interest are less than comprehensive.

Recommendations

1) Revisit phase-in of ASBE compliance, consider adjustments to reduce anomalies.
2) Consider strengthening the Chinese version of IAS 37 to require disclosure of corruption-related contingent liabilities.
3) Require CEO and CFO certification of financial statements.
4) Require auditors to report fraud and corruption to the authorities, and provide a safe harbor protecting the auditors from liability.
5) Tighten safeguards against auditor conflict of interest, and strengthen enforcement of corporate governance rules including accounting and audit standards.

P.R. China Laws, Regulations, Policy Documents Referenced:

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Audit Law of the People's Republic of China, 2006, http://www.asianlii.org/cn/legis/cen/laws/alotproc340/.

“China's Efforts to Combat Corruption and Build a Clean Government,” Cabinet White Paper, Information Office of the State Council, People's Republic of China, 2010.

Companies Law of the People's Republic of China, No. 42/2006, http://www.asianlii.org/cn/legis/cen/laws/cl119/.

Internal Audit Guideline No. 2301 - Management of internal audit 2013-08-29, http://www.ciia.com.cn /docs/fg_xg_nszz/2013-08-29/1377736115982.html.

Internal Audit Guideline No. 2306 - Internal Audit Quality Control, 2013-09-02, http://www.ciia.com.cn/docs/fg_xg_nszz/2013-09-02/1378087210697.html.

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[3] http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/china/show-all.aspx.

[4] http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/china/show-all.aspx.

[5] http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/china/show-all.aspx.

[6] "China's Efforts to Combat Corruption and Build a Clean Government," Cabinet White Paper, Information Office of the State Council, People's Republic of China, 2010.

[7] http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/china/show-all.aspx.

[8] http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/china/show-all.aspx.

[9] The sources of all standards are provided in footnotes to the tables presented in the section of the Review entitled *International Standards for Country Reports.*

[10] Ministry of Finance, Commission on Audit, China Securities Regulatory Commission (CSRC), China Banking Regulatory Commission (CBRC), and China Insurance Regulatory Commission (CIRC). *Issuance of "Internal Control Standards" Notice*, *Accounting*, 2008, No.7, http://kjs.mof.gov.cn/zhengwuxinxi/zhengcefabu/200807/t20080704_55982.html.

[11] PWC (2011), "Opportunities to improve financial reporting and internal controls in China CAS and C-SOX," p.9, http://www.pwc.com/gx/en/automotive/industry-publications-and-thought-leadership/opportunities-to-improve-financial-reporting-and-internal-controls-in-china-cas-and-c-sox.jhtml; "China's Basic Standard for Enterprise Internal Control," 2011, http://alexraymond.hubpages.com/hub/C-SOX; http://www.sasac.gov.cn/n2963340/index.html.

[12] The Basic Standard was available to the author in informal translation only. Whether "should" refers to a mandatory requirement or recommended guideline is unclear from the document.

[13] Audit Law of the People's Republic of China, 2006, http://www.asianlii.org/cn/legis/cen/laws/alotproc340/.

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[16] See previous footnote about “should” in the Basic Standard translation.
[17] Eunice Ku (2012), “China’s Internal Control and Audit Regulatory Framework,” *China Briefing*, http://www.china-briefing.com/news/2012/03/09/chinas-internal-control-and-audit-regulatory-framework.html.
[18] Securities Law of the People’s Republic of China, No. 43 (amended 2005), arts.124, 136, http://www.asianlii.org/cn/legis/cen/laws/slotproci2005504/.
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[22] http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/china/show-all.aspx.
[23] http://online.wsj.com/news/articles/SB10001424052702304027204579334162357059046
[24] Accounting Law of the People’s Republic of China, 1985 (amended 1993), http://www.asianlii.org/cn/legis/cen/laws/alotproc387/. The Law applies to “[s]tate bodies, public organizations, enterprises, institutions, self-employed industrialists and businessmen and other organizations,” (art.2).
[25] http://www.ifrs.org/Use-around-the-world/Documents/Jurisdiction-profiles/China-IFRS-Profile.pdf.
[26] World Bank (2009), *Report on the Observance of Standards and Codes (ROSC) – Accounting and Auditing: People’s Republic of China*, p.14, http://www.worldbank.org/ifa/rosc_aa_chn.pdf.
[27] All currency conversions are at interbank rate as of Feb. 25, 2014, http://www.oanda.com/currency/converter/.
[28] Action Plan Developed by The Chinese Institute of Certified Public Accountants (CICPA), 2013, p.7, http://www.ifac.org/sites/default/files/compliance-assessment/part_3/201312%20China%20CICPA.pdf.
[29] Law of the PRC on Certified Public Accountants, No. 13/1993, http://www.asianlii.org/cn/legis/cen/laws/cpa247/.
[30] The specific sanctions are in several cases not given but said to be defined elsewhere. For example, art.216 of the Companies Law states that, for offenses arising from violation of the Act, “criminal responsibility shall be investigated according to law.”

Cook Islands

1. Introduction

The Cook Islands comprises 15 small islands, spread over 2.2 million square kilometers, with a resident population of some 13,900. The country is a parliamentary democracy and member of the Commonwealth that is self-governing in “free association” with New Zealand. The Cook Islands is responsible for its own internal affairs, while New Zealand has authority over external affairs, in consultation with the Cook Islands’ government. Cook Islanders hold New Zealand citizenship, enjoy the right of free access to that country, and use the NZ dollar as the official currency. The country has a unicameral parliament and also a 15-member House of *Ariki* (Chiefs), which advises the Government on land use and customary issues.[1]

Although its per capita GDP is high compared to many other Pacific Island countries, the Cook Islands suffers from constraints typical of the region. Economic development is hindered by the isolation of the country from foreign markets, the limited size of domestic markets, lack of natural resources, periodic devastation from natural disasters, distance and disparity among its islands, and limited infrastructure. Agriculture and increasingly tourism provide the economic base along with limited manufacturing. Trade deficits are offset by remittances from emigrants and by foreign aid, mainly from New Zealand. [2]

The Cook Islands offshore financial sector is a significant part of the country’s economy. While this brings in business and drives the development of the legal structure for corporate governance, it also raises the risk of money laundering. The Cook Islands has taken steps to reduce the risks and align with the Financial Action Task Force standards on combating money laundering and terrorism financing. International observers still have concerns about this vulnerability, with the Tax Justice Network, for example, ranking the Cook Islands as one of the world’s most secretive financial centers. The problems cited here include overly broad bank secrecy rules, and the fact that resident agents are not compelled by law to report to the tax authorities on their payments to non-residents. The Cook Islands have enacted anti-money laundering legislation to override certain banking secrecy provisions related to information on company beneficial ownership and identification. The country was successful in its effort to remove itself from the Financial Action Task Force’s list of problem states, although it remains on the OECD’s list of states not adequately implementing international tax standards.[3]

2. General efforts to prevent corruption involving the private sector[4]

The Cook Islands has a number of laws and institutions that address corruption, but there do not appear to be significant initiatives on private sector corruption. The penal laws criminalize passive and active bribery of officials. The laws, however, do not address indirect bribery through intermediaries or bribery of foreign officials. Regulations concerning conflicts of interest and political campaign finance disclosure are also considered to be quite limited. The Cabinet formalized the Anti-Corruption Committee in September 2011.[5] The chairmanship of the Committee is on a two-year rotational basis among members and is currently held by the Solicitor General. The Committee also includes the Ombudsman, the Head of the Financial Intelligence Unit, the Police Commissioner, Director of Audit, Financial Secretary, Public Service Commissioner and the Chief of Staff. The Committee works as a watchdog to detect corrupt activities in the public sector and promotes integrity, transparency and accountability. The Committee is not considered to be an independent anti-corruption agency.

A few other institutions are worth mentioning. The Audit Act of 1995 established the Audit Office, which oversees fiscal administration including procurement. The Act also protects the identity of individuals who report irregularities. The Cook Islands' Ombudsman is in charge of investigating complaints reported by citizens about the central government, and is responsible for the Cook Islands Human Rights Office. The Official Information Act of 2008 gives the Ombudsman the mandate to review and investigate complaints regarding access to information requests. The Office of the Ombudsman reportedly lacks sufficient human and financial resources to respond adequately to the demand for government information. The local media have criticized the government for not investing enough resources in awareness-building around the Act.

Also, the Financial Intelligence Unit provides channels for reporting suspicious transactions related to serious offenses, including corruption-related transactions. The Financial Transactions Reporting Act 2003 (FTRA) provides protection for any person or entity so reporting (art.15).

There are many civil society organizations in the country, which have played a significant role in public life in recent years.[6] Most are reported to be local associations, with perhaps five of the large organizations being funded by international agencies. CSOs have been gathered in an umbrella group, the Cook Islands Civil Society Organizations, to exchange information and provide mutual support.[7]

International standard[8]	Compliance by member country
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	NGOs appear to be active in civic affairs, and there is some government outreach to private and civic sectors.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) The Audit Office and the Ombudsman provide channels for reports and complaints. The Audit Act requires the former to protect confidentiality. Also, the FIU provides channels for reporting suspicious transactions including corruption. FTRA provides protection for any person or entity reporting. 2) No known provision.
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) to 3): Public-private cooperation is limited. There are no known codes of business ethics or corporate governance. However, the FIU reportedly has established relationships with financial institutions and related private sector entities required to report under the FTRA.
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	Integrity pacts do not appear to be used to any significant extent.

3. Internal controls

The Cook Islands' offshore banking sector considerably raises the stakes for corporate governance and internal control. Investor-friendly vehicles such as international companies, limited liability companies, and trusts are used as wealth management tools in a setting that largely shields them from tax, disclosure, and enforcement of international judgments.[9]

A. Internal audit

In the Cook Islands, internal audit is not required of companies generally, although the FTRA (art.18) does require financial institutions to establish an audit function to test their anti-money laundering (AML/CFT) procedures and systems. Money laundering concerns include any serious offenses in the Crimes Act 1969, or other offenses carrying a penalty of NZD 5,000 (USD 4,350[10]) fine or 12 months' imprisonment. Reporting institutions under the FTRA include banks, trustee companies, lawyers, accountants, NGOs, motor vehicle dealers, pearl dealers, and firms in real estate, money transfers, and insurance.[11] Also, international companies would have to comply with their home country rules.

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	Internal audit is legally required only for financial institutions and related entities reporting under FTRA.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect "illegal acts" in the books and records of companies, including bribery and other forms of corruption.	1) and 2) No organized internal audit profession.
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	1) No internal audit requirements for companies generally. However, reporting Institutions under FTRA are required to establish an internal audit function to test AML/CFT procedures and systems. 2) and 3): FTRA requirement relates to AML/CFT, which would cover suspicious transactions including any related to serious offenses. The latter would include fraud and corruption. 4) No provision.

B. Audit committee

There appear to be no audit committee or supervisory board requirements.

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	1) and 2): No provision.
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers, employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	1) through 5): No provision.

C. Internal control and compliance systems

Internal control requirements exist, but apply only to the financial sector. The Banking Act,[12] as in other countries of the region, includes internal control issues in the criteria for financial institution licensing and supervision. The Financial Supervisory Commission considers, in deciding on the issuance of a financial services license, whether the institution has adequate risk management, accounting, and internal control systems (art.7). These matters are also reviewed as part of the FSC's supervision generally and its on-site compliance inspections (arts.17-18). Further, the Commission may request an auditor to report on the adequacy of an institution's accounting and control systems (art.51). In addition, under the Financial Supervisory Commission Act 2003,[13] (art.17), every licensed institution is required to have a compliance officer to meet its legal-regulatory obligations concerning customer identification, record keeping and retention, and other matters prescribed by legislation. Last, the FTRA (art.18) requires financial institutions to establish internal control measures to address AML/CFT requirements. These measures include appointing a Money Laundering Reporting Officer to ensure compliance with training, due diligence, and reporting requirements.

International standard	Compliance by member country
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees. 4) Risk-based approach: • Individualized assessment of risks to the enterprise, including corruption risks. • Regular monitoring and re-assessment of corruption risks.	1) No general internal control requirements. Financial institutions must have internal controls to meet licensing and prudential standards. FSC may require bank's auditor to report on adequacy of internal controls. 2) Financial institutions: FSCA requires controls on accounting and financial reporting. FTRA requires internal control measures for financial institutions to deal with AML/CFT. 3) Financial institutions: FSCA requires compliance officer. FTRA mandates an MLA officer, due diligence, training. 4) Financial institutions: Government reports that it considers corruption a predicate offense for AML/CFT, and is conducting a second AML/CFT National Risk Assessment.
Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements. 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable	1) Adherence to such laws would be part of basic controls. 2) through 4): No provisions.

donations. 4) Require for third-party representatives, consultants, or agents: • Written contract, adherence to company ethics standards and anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	
Enforcement, including sanctions for failure to comply.	FSC uses supervisory authority to ensure requirements are met by licensed institutions.

4. Integrity of financial statements

A. Accounting

1. Financial records

Retention of documents is addressed in the corporate and banking legislation. The Limited Liability Companies Act[14] (art.74) permits the keeping of required books, accounts, and documents in written, magnetic, electronic or any other data storage form, provided the LLC can readily produce legible printed evidence of their contents. A 2013 amendment[15] clarified that an LLC must keep accounting records sufficient to show and explain the company's transactions, giving a true and accurate record of all sums received and spent, sales and purchases, assets and liabilities and transactions affecting them (art.5). The records must enable the financial position of the company to be determined with reasonable accuracy, and must be retained by the resident agent in the Cook Islands in hard copy or electronic format. A manager who fails to take all reasonable steps to ensure the LLC's compliance is guilty of an offense.

International Companies must meet this same requirement under their corporate legislation, and must retain such records for six years.[16] The International Companies Act (art.193 (5)) penalizes wilfully making statements in company documents that are materially false. In addition, where the international company is a Registered Listed Company, the Company Registrar may apply for a court order that the company's records are to be preserved and not moved. Such an order may be made for purposes of investigation to protect minority shareholders and related matters (arts.126Y, 126BB).

The six-year retention period applies to financial institutions as well. The Banking Act applies this rule to checks, bills of exchange, and other documents specified by the Financial Supervisory Commission (FSC). The Act prohibits destruction within six years (art.63) and penalizes false or misleading statements or entries in company records – including by omission (art.56). The FTRA (art.6) requires reporting institutions to maintain records for a minimum period of six years in the Cook Islands or elsewhere, and if elsewhere the records must be in a form that will allow the FIU to reproduce them within three working days.

International standard	Compliance by member country
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	Legislation on LLCs, international companies, and banks requires proper retention of records – six years in the case of ICs and banks. The FTRA also requires reporting institutions to maintain records for six years.
Prohibitions (UNCAC 12(3), OECD Convention 8(1)), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	1) International companies and banks: false statements in corporate records prohibited and penalized. 2) Early destruction of records expressly prohibited for banks, prohibited by implication for ICs. 3) through 6): No explicit prohibition, but "true and accurate" requirement covers this generally for LLCs, ICs, and banks. Also, ICs and banks are expressly prohibited from making false entries in records.

2. Financial reporting requirements

The Cook Islands' corporate and banking legislation provides a gradation of requirements for different kinds of entities. The LLC Act (art.48) empowers company members to inspect company records and obtain "true and full information regarding the state of the business and financial condition" of the company, along with accounts and tax documents, as specified in the company operating agreement or procedures. Similar provisions apply to trust companies, which must also submit annual returns.[17]

The International Companies Act (arts. 112, 115, 126CC) requires each company to submit an annual return, signed by a company director or secretary, to the Registrar. The return must be accompanied by a certificate from a registered company auditor stating that the company has kept proper accounts and prepared a balance sheet and profit and loss account, and that the certifying auditor has audited the statements. The return is to include as well a certificate from a company director stating that audited accounts show the company to be solvent, and that there are no reasons or events since the accounting that would make the accounts untrue. Non-compliance is an offense by the company and every officer who is in default. The balance sheet and profit and loss account must give a true and fair view of the state of affairs of the company (with appropriate exceptions for consolidated financial statements). Directors who fail to ensure compliance are subject to fines and imprisonment. Special regulations may be issued for returns by foreign companies (art.207). In addition, the Banking Act (art.48) requires licensed institutions to submit regular reports, financial statements, and other specified information to the FSC.[18]

As for financial reporting standards in the Cook Islands, the Audit Office in 2008 stated that it was planning for gradual transition to IFRS. In the following year, the National Superannuation Fund stated that, effective January 1, 2013, voluntary early adoption of IFRS would be permitted, and that IFRS would be adopted as of the end of 2013.[19]

International standard	Compliance by member country
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) to 3) Public sector has announced a transition to IFRS. No official commitment exists to apply IFRS to the private sector.
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) True and fair requirement in corporate laws encourages disclosure, but no express requirement. 2) Banks and ICs prohibited from making false entries in statements, reports, documents.

B. Audit

1. Auditing requirements

The Limited Liability Companies Act imposes no general requirement of annual audits, but the Registrar may decide to appoint auditors of LLCs as appropriate (art.75). These auditors must be chosen from a list of registered auditors to be kept by the Registrar. International companies, by contrast, are required to perform annual audits unless certain conditions apply. The companies need not do so if they do not issue shares or debentures or accept deposits or loans, and if the company general meeting resolves that the company will not appoint an auditor (IC Act, arts.116-117). Otherwise, the company must have a registered company auditor carry out an audit of the company's accounts and report to the company members. The auditor is to obtain all necessary information and explanations concerning the affairs of the company (and related companies). The company must take all proper steps to ensure the auditor has access to the necessary books and records, and can obtain needed information and explanations (IC Act, arts.124-125). Also, as stated above, the annual return is to include a certificate from a company director attesting the accuracy of the audited accounts (art.112). Trust companies must also have annual audits done by registered company auditors (Trustee Companies Act art.27).

The Banking Act (arts.47, 49) requires financial institutions to carry out audits as well, and to obtain the FSC's approval of the auditor appointed. The auditor is to prepare a report stating whether necessary and sufficient information and explanations were provided, whether accounts have been properly kept, the financial statements provide a true and fair view of the company's finances, and the statements are in agreement with the company accounts. The financial statements and audit reports are to be submitted to the AGM and the FSC. Banks licensed abroad are exempt if able to provide an audit report from a duly qualified auditor in the home country (art.52).

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	Audit requirements appear less than comprehensive but proportionate. Effectiveness in practice is unclear.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	1) and 2): Banks, trust companies, and international companies that accept funds from the public or issue securities must conduct annual audits. Other companies may be required to do audits in defined circumstances.
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	Audit standards do not appear to be regulated. Companies that are required to perform audits are likely to use international standards, particularly as applied by New Zealand.
Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks. 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	1) Per Banking Act: Financial institution audit reports must state whether financial statements are true and accurate, whether statements agree with accounts, and whether accounts have been kept properly. FSC may require bank auditor to report on accounting and internal control systems. 2) Per International Companies and Banking Acts: Company must provide all necessary records, information, and explanations to auditor. False entries in statements, reports, documents prohibited. Certification of accounts by director required.

2. *Auditor reporting of improprieties*

There is no general duty for auditors to report irregularities, nor any general safe harbor provision. Indeed, the LLC Act (art.72) includes a strong requirement of confidentiality with respect to any information on the membership, management, assets, or finances of an LLC. Anyone who divulges such information or attempts, incites, or is party to such disclosure is guilty of an offense – with certain narrowly-drawn exceptions such as disclosure by company officers to auditors or attorneys, and court orders. The International Companies Act contains a similar provision (art.8). On the other hand, the Banking Act (arts.50-54) requires an auditor to disclose to the FSC any crimes of fraud or dishonesty and any serious irregularities, among other things, discovered in the course of an audit. The auditor is subject to fines for failure to do so. The auditor must inform the audit client in advance if possible, and be available for further queries by the Commission. No civil, criminal, or disciplinary liability attaches to the auditor making disclosures to the FSC in good faith. Further, under the FTRA (art.12), auditors and supervisors of reporting entities must report to the FIU any suspicious transaction or attempted transaction discovered in the course of their work.[20] In other respects, protections for the confidentiality of banks' corporate information – from disclosure by FSC or others – are quite robust and enforceable by heavy fines.

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	No explicit requirement of internal reporting. Audits conducted under ISA would have such a requirement.
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").	1) No general duty of auditors to report externally. Per Banking Act, financial institution auditors must report serious irregularities and crimes of fraud or dishonesty to FSC. Also, suspicious transactions identified by an auditor or supervisor of a reporting institution must be reported to the FIU. 2) Liability for serious penalties attaches to FSC and others for disclosures not within the exemptions to the confidentiality rules. Good faith reporting of irregularities to FSC and of suspicious transactions to FIU is protected from liability under the respective statutes.

C. Professional standards and independence

The Cook Islands appears to have no organized accounting and audit profession of its own, but to rely on professionals qualified overseas (mainly New Zealand). The International Companies Act (arts.116-118) provides that such companies must give notice to the Registrar of the appointment or removal of an auditor. After the initial term, auditors are to be appointed for two financial years at a time. The Banking Act (art.47) includes similar requirements for financial institutions, along with safeguards of the auditor's independence. Auditors may not be appointed, or approved by FSC, unless they are qualified and have no financial interest in the licensed institution (apart from deposits) nor a position as shareholder, officer, employee, or agent. If the auditor is in breach of these independence criteria, the appointment automatically ceases and the institution is subject to fines.

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) and 2) No organized accounting profession. Accountants qualify in a foreign country.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	1) IC, Trustee Companies, and Banking Acts provide for appointment of registered company auditors. 2) to 3): No restriction. 4) Banking Act prohibits appointment of auditor with financial interest or position with the bank. 5) No restriction.
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) through 4): No organized audit profession. Auditors qualify in foreign countries and are accountable to professional bodies there. They must also be approved by the Registrar and listed as registered company auditors.

D. Enforcement

Penalties are provided in the corporate and banking legislation for financial reporting and auditing offenses, though the effectiveness of enforcement is not clear. The Limited Liability Companies Act (art.78) provides generally for fines up to NZD 10,000 (USD 8,700) and imprisonment for up to one year for violations of the Act, and specifically for material misrepresentations made wilfully or negligently in documents filed with the Registrar. Under the International Companies Act, improper disclosure of confidential corporate information is subject to fines up to NZD 10,000 (USD 8,700) and imprisonment for up to two years. A director of a registered listed company who fails to ensure that the company’s financial statements provide a true and fair view of the state of its affairs is liable to fines up to NZD 10,000 (USD 8,700), and imprisonment for up to six months if the offense is wilful. Further, anyone who wilfully makes a materially false or misleading statement in any documents required under the IC Act is subject to fines up to NZD 1000 (USD 870) and up to six months’ imprisonment (arts. 193(5), 219(2)). The Financial Services Commission Act (art.22) punishes improper disclosure of corporate information by FSC officials with fines up to NZD 20,000 (USD 17,300) and imprisonment for up to two years. The Banking Act (art.47) imposes fines up to NZD 50,000 (USD 43,400) on licensed institutions that fail to appoint approved auditors or conduct annual audits, and the same penalty for auditors who fail to disclose serious irregularities and frauds to FSC as required (art.50).

International standard	Compliance by member country
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2): It is not clear whether these rules and procedures are used effectively to combat corruption.
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) and 2): Per IC Act: Fines up to USD 8,700 and 6 months' imprisonment for directors of listed companies if financial statements are not true and fair. Deliberate misstatements in account subject to fines up to USD 870 and 6 months' imprisonment. 3) Effectiveness of enforcement is not clear.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) See above. Also, per LLC, IC, FSC Acts: Improper disclosure of corporate information subject to fines up to USD 17,300 and imprisonment for up to 2 years. Per Banking Act, auditors failing to disclose improprieties as required are subject to fines up to USD 43,400. 2) Per Banking Act: Institutions failing to appoint approved auditors or do annual audits subject to fines up to USD 43,400. 3) Effectiveness of enforcement is not clear.

5. Conclusion and recommendations

A. General efforts to prevent corruption involving the private sector

The Cook Islands, though a very small country, has established an Anti-Corruption Committee, an Ombudsman, and an Audit Office, all of which have a role in combating corruption including the provision of reporting and complaint channels. The Official Information Act further provides citizens the opportunity to exert their rights to information. Several NGOs are active in related areas. But public-private cooperation appears to be limited, and some of the above initiatives suffer from this. There do not appear to be any incentives offered for self-reporting of corruption offenses, nor are integrity pacts used to any significant degree.

Recommendations

1) Build on ACC, Ombudsman, and Information Act to develop public-private cooperation on issues of private sector corruption.
2) Strengthen laws on private sector corruption including campaign finance abuses and foreign bribery.
3) Develop and raise awareness about legal incentives such as sentence-mitigation for self-reporting of corruption offenses. Consider adopting legal protections for whistle blowers.
4) Draw on the capacities of international investors to promote integrity pacts across major sectors of the economy, including banking and wealth management.

B. Internal controls

This area is underdeveloped in the Cook Islands, especially given the importance of its international corporate and banking sector. Companies are not required to establish an internal audit function or an audit committee or supervisory board. As for internal control and risk management systems, only financial institutions are required to maintain them – and to designate a compliance officer to see to their functioning. AML/CFT requirements apply to financial institutions as well.

Recommendations

1) Adopt audit committee and internal audit requirements for banks, international companies, and LLCs meeting a size threshold.
2) Extend internal control requirements to international companies and LLCs meeting a size threshold.
3) Adopt a corporate governance code detailing all internal control-related standards and incorporating measures to prevent corruption.

C. Integrity of financial statements

Companies are required to retain documents in hard copy or electronic format, and ICs and banks must keep them for six years. Early destruction and falsification or manipulation of records are in some cases expressly prohibited. Annual financial statements must be prepared by ICs and banks, while LLCs and trust companies must make available to members company records that provide an accurate financial picture (and trusts make annual returns). The ICs must also have a director certify the accounts in an annual return. The Cook Islands does not appear to have its own accounting or audit standards, but the profession likely follows international standards as practiced in New Zealand. The Audit Office has called for adoption of IFRS, but this appears to apply only to the public sector. Banks, trust companies, and international companies soliciting financing from the public must carry out annual audits, while others do so on demand. Bank auditors must report serious irregularities and frauds discovered in an audit to the FSC and FIU, and are protected from liability in doing so, while others are constrained by strict confidentiality rules and heavy penalties. The Cook Islands has no accounting and audit profession of its own, nor a professional governing body. It relies on foreign-qualified auditors vetted and listed by the Company Registrar. Protections for the independence of auditors are clear but do not address non-audit work or hiring of former auditors. As for enforcement, the laws in this area provide for maximum fines over USD 40,000 and imprisonment for up to two years for the most serious violations. The effectiveness of enforcement in practice is not clear.

Recommendations

1) Adopt a uniform seven-year record retention rule for all companies, with clear definitions of the required documents and prohibition of the various document destruction and manipulation methods associated with concealment of corruption.

2) Require financial statements to be prepared by LLCs, trust companies, ICs, banks, and any other structure that serves as an international investment vehicle. Mandate preparation of the statements according to IFRS and auditing in accordance with ISA.
3) Extend the provisions on auditor reporting of improprieties, and the corresponding safe harbor provision, beyond the financial sector to international companies, trusts, and LLCs – uniformly or based on a threshold defined in terms of size or international participation.
4) Require current certificates of good standing and compliance with continuing education and ethical compliance from the licensing authorities of all registered company auditors.

Cook Islands Laws, Regulations, Policy Documents Referenced:

Banking Act 2011 No.15, https://www.fsc.gov.ck/cookIslandsFscApp/content/assets/b22d4f53dabf76f6091368f2a380c5a5/Banking%20Act%20%202011%20%20%20131211.pdf.

Financial Supervisory Commission Act 2003, https://www.fsc.gov.ck/cookIslandsFscApp/content/assets/638a4efd0b7f491a1639a4d770ee7be7/Financial%20Supervisory%20Commission%20Act%202003.pdf.

Financial Transactions Reporting Act, 2003, http://www.paclii.org/ck/legis/num_act/ftra2003335/.

International Companies Act 1981-82 (as amended), http://www.cookislandsfinance.com/legislation-pdf/International-Companies-Act-1981-82-2005-Consolidation.pdf.

International Companies Amendment Act No.12/2013, https://www.fsc.gov.ck/cookIslandsFscApp/content/assets/ce091d4794397f0a6cff2b9c2ba58d34/International%20Companies%20Amendment%20Act%202013.PDF.

Limited Liability Companies Act No. 7/2008, http://www.cookislandsfinance.com/legislation-pdf/Limited-Liability-Companies-Act.pdf.

Limited Liability Companies Amendment Act No.16/2013, https://www.fsc.gov.ck/cookIslandsFscApp/content/assets/671faf27add17f43a9db4838e48dc4d3/LLC%20Amendment%20Act%202013.PDF.

Trustee Companies Act 1981-2 No.27, arts.28-9, https://www.fsc.gov.ck/cookIslandsFscApp/content/assets/fab4a448c77237164333228be5ab6b90/Trustee%20Companies%20Act%201981-82.pdf.

NOTES

[1] http://www.governance.usp.ac.fj/top-menu-29/countries-and-territories-175/cook-islands-197/; http://www.dfat.gov.au/geo/cook_islands/cook_islands_brief.html.
[2] https://www.cia.gov/library/publications/the-world-factbook/geos/cw.html.
[3] http://www.transparency.org/files/content/corruptionqas/Overview_of_corruption_and_anti-corruption_in_Cook_islands.pdf; government comments.
[4] *Source: h*ttp://www.transparency.org/files/content/corruptionqas/Overview_of_corruption_and_anti-corruption_in_Cook_islands.pdf.
[5] Cabinet Memorandum (11) 0369; government comments.
[6] Government reports 33 CSOs as of 2013, with over 150 having been deregistered from 2009 to 2012.
[7] There may be other initiatives not covered here due to limited information.
[8] The sources of all standards are provided in footnotes to the tables presented in the section of the Review entitled *International Standards for Country Reports.*
[9] http://www.cookislandsfinance.com/. The government points out that, since 2010, offshore banks are not allowed to operate without a domestic banking license. This does not appear to have had a significant impact on the offshore finance sector. Wayne, Leslie, “Cook Islands, a Paradise of Untouchable Assets,” *The New York Times*, Dec. 15, 2013, http://www.nytimes.com/2013/12/15/business/international/paradise-of-untouchable-assets.html.
[10] Currency conversions based on interbank rate of March 30, 2014, http://www.oanda.com/currency/converter/.
[11] Government comments.
[12] Banking Act 2011 No.15, https://www.fsc.gov.ck/cookIslandsFscApp/content/assets/b22d4f53dabf76f6091368f2a380c5a5/Banking%20Act%20%202011%20%20%20131211.pdf.
[13] Financial Supervisory Commission Act 2003, https://www.fsc.gov.ck/cookIslandsFscApp/content/assets/638a4efd0b7f491a1639a4d770ee7be7/Financial%20Supervisory%20Commission%20Act%202003.pdf.
[14] Limited Liability Companies Act No. 7/2008, http://www.cookislandsfinance.com/legislation-pdf/Limited-Liability-Companies-Act.pdf.
[15] Limited Liability Companies Amendment Act No.16/2013, https://www.fsc.gov.ck/cookIslandsFscApp/content/assets/671faf27add17f43a9db4838e48dc4d3/LLC%20Amendment%20Act%202013.PDF.
[16] Cook Islands International Companies Act 1981-82 (as amended), arts.113, 228A, http://www.cookislandsfinance.com/legislation-pdf/International-Companies-Act-1981-82-2005-Consolidation.pdf; International Companies Amendment Act No.12/2013, art.4, https://www.fsc.gov.ck/cookIslandsFscApp/content/assets/ce091d4794397f0a6cff2b9c2ba58d34/International%20Companies%20Amendment%20Act%202013.PDF.
[17] Trustee Companies Act 1981-2 No.27, arts.28-9, https://www.fsc.gov.ck/cookIslandsFscApp/content/assets/fab4a448c77237164333228be5ab6b90/Trustee%20Companies%20Act%201981-82.pdf.

[18] The government also points out that the FTRA (arts.10-12) requires reporting institutions to report to the FIU any cash transactions and electronic funds transfers over the threshold of NZD 10,000 (USD 8,700), and any suspicious transactions.

[19] http://www.adoptifrs.org/CountryDescription.aspx?CID=50.

[20] While the language of the statute is not fully clear on this point, the government states that the duty to report applies to both internal and external auditors. FTRA art.16 shields those making such reports in good faith from liability.

Fiji Islands

1. Introduction

Among Pacific island nations, the Republic of Fiji is one of the most populous and economically developed, with approximately 900,000 people and per capita GDP estimated at USD 4,670. Fiji Islands has considerable economic endowments, including a well-developed financial system and natural resources such as forests, fisheries, and mineral deposits. The Fiji Islands-based South Pacific Stock Exchange is quite small, with 18 listed securities, but it has experienced growth, and its oversight by the Reserve Bank of Fiji Islands (RBF) and the Capital Markets Unit [1] has helped raise corporate governance standards. Fiji Islands' chief economic policy focus has been shifting from a reliance on sugar and textiles to a focus on tourism and related industries.

Fiji Islands' relatively small population and limited circles of power mean that personal relationships sometimes play a major role in business and government decisions. In 2007, the government established the Fiji Independent Commission Against Corruption (FICAC), with broad powers of investigation in order to tackle public sector corruption.[2]

2. General efforts to prevent corruption involving the private sector

The anti-corruption agency, FICAC, has the lead official role in coordinating public-private efforts against corruption. FICAC's Commissioner takes the lead in setting policies and priorities, and reports directly to the President of Fiji Islands.[3] The Commission enforces the Prevention of Bribery Promulgation 2007, which outlaws active and passive bribery, including bribery of agents for both public and private sector principals.[4] Based on the Hong Kong ICAC model, FICAC has departments dedicated to investigations and assessment of complaints, legal affairs, and community relations. It also has the power to prosecute offences under the Promulgation.

FICAC's Community Relations and Corruption Prevention Department is tasked with promoting awareness about corruption and related issues through education, training, and media programs. A team of Awareness Officers advocate and educate about the prevention of corruption in government bodies as well as in the private sector, and hold workshops at schools around the country. The Department also holds sessions on corruption prevention for companies and chambers of commerce. The Commission emphasizes the importance of "setting the tone at the top" to create an ethical environment in the workplace – which requires managers to lead by example and to show that unethical conduct is not tolerated. In addition, the enabling decree, the FICAC Promulgation, includes in the Departments' responsibilities the fostering of public support in combating corruption and advising and assisting organizations on ways to eliminate corrupt practices.[5]

Civic organizations and NGOs such as Transparency International-Fiji Islands also conduct programs on citizen education, open public budgeting, and other public sector corruption-related themes.[6] The Fiji institute of Accountants has also been organizing seminars and other events on covering ethics standards as well as financial reporting. The Institute of Accountants has since 2009 required accountants to complete two university course units, including one on Governance and Ethics, to qualify as full chartered accountants.

International standard[7]	**Compliance by member country**
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	Outreach by FICAC and NGOs focusing on the public sector.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) FICAC provides channels for reporting and complaints. RBF regulation (BSPS No.10, see below) addresses whistle-blowing. 2) No apparent provision for sentence-mitigation.
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) and 2): FICAC offers advice and training to public and private organizations on prevention of corruption. 3) FICAC advocates and supports ethics codes and positive "tone at the top" in organizations public and private. Financial and banking regulators issued corporate governance codes (see below).
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	Integrity pacts not used to any significant degree.

3. Internal controls

There are no requirements concerning internal controls for companies generally. Listed companies and licensed stock market intermediaries, however, are subject to standards on internal control and other good corporate governance norms. These standards, embodied in the Corporate Governance Code[8] adopted by the Capital Markets Development Authority (now the Capital Markets Unit or CMU), are applied on a “comply or explain” (“if not, why not”) basis. The Code is mandatory for licensed institutions, i.e. each of its standards compels a response (comply or explain) that meets the approval of the regulatory, the CMU. The Code applies to four licensed intermediaries and 16 other (listed) companies. The listed companies are required to provide a statement in their annual report disclosing the extent to which they comply with each element of the Code, and if not, the company must identify the principle or recommendation that they have not followed and give reasons for not following it.[9] Parallel mandatory standards for financial institutions are provided in the Policy Statement (BSPS) on Minimum Requirements on Corporate Governance, issued by the Reserve Bank of Fiji.[10]

A. Internal audit

The Corporate Governance (CG) Code (Principle 9, Recommendation 9.1) advises that each company should consider having an internal audit function. An alternative mechanism may be used to achieve the same outcome depending on the company’s size and complexity and the types of risks involved. In order to present a balanced and understandable assessment of their position, companies are to appoint internal and external auditors, and ensure that the roles, responsibilities and reporting channels of the auditors are clearly defined. The RBF Requirements on Corporate Governance (para.4.4.1) provide that licensed financial institutions must have an independent internal audit function – or if it decides not to do so, an institution must obtain prior written approval for an exemption from RBF. The internal audit function may take the form of an in-house unit, an internal audit function for a group of companies, or a service outsourced to an accountancy firm. The internal audit function reports directly to the Board Audit Committee.

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	Listed companies, stock market intermediaries, and financial institutions advised/ required to have internal audit function, per CMDA (CMU) and RBF corporate governance standards. Others not required to do so.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect "illegal acts" in the books and records of companies, including bribery and other forms of corruption.	1) and 2): No internal audit profession as such, and no legally-defined duties. The IIA-Fiji chapter is active in upholding professional standards and providing training for members.
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	1) to 3): Basic internal audit functions stipulated in CMDA and RBF instruments. No express provision for internal auditor to deal with internal controls, fraud, or corruption. (Internal controls are left to the audit committee, see below.) 4) Per RBF rules, internal audit to report directly to audit committee (financial institutions).

B. Audit committee

The CG Code likewise advises establishment of an audit committee of the board (Recommendations 2.1, 9.2): "The board must establish a board audit committee" (Rec.9.2), which "must have a formal charter which clearly defines functions, responsibilities and reporting channels" (Rec.2.1). The committee is to provide independent oversight of the company's internal control and operations, verifying and safeguarding the integrity of the company's financial reporting. It should have at least three members, the majority being independent, and the committee chair must not be the chairman of the board.

The RBF Requirements (para.4.2.6) stipulate that each board committee must have a written charter, and each board must have an audit committee. The latter committee should provide independent oversight of internal control and operations. The audit committee's duties include nominating the external auditor and safeguarding the scope, independence, and cost-effectiveness of the audit. The committee must have at least three members and a chair who is a non-executive director with an accountancy or related qualification. No executive directors or senior management members are permitted to serve on the audit committee, and the committee must meet annually with the internal and external auditors, and the company compliance and legal units, without management being present.

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	Per CMDA (CMU) and RBF standards: 1) Audit committee of the board required. 2) Committee to include independent directors. Bank audit committees to be headed by qualified accountant or equivalent (RBF).
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers, employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	Per CMDA (CMU) and RBF standards: 1) Audit committee to oversee financial reporting, internal and external audit. 2) Audit committee to supervise internal controls. Risk management, ethics code, and compliance to be overseen by risk management committee (see below). 3) through 5): For financial institutions, RBF standards (see below) require ethical code including rules addressing corruption and protection for whistleblowers.

C. Internal control and compliance systems

The CMDA/CMU and RBF standards on corporate governance provide for internal controls. The CG Code advises that companies should include disclosures in their annual reports on material risk factors, governance structures and policies, and the company's compliance with the CG Code. Companies should have vetting and authorization processes that ensure that the company's announcements are clear, accurate, and timely (CG Code Recommendation 5.1).

Companies should, further, establish a minimum code of conduct for the company and encourage compliance (CG Code Recommendation 6.1). The board has a responsibility to set the tone and the ethical standards of the company and to oversee adherence to them. Senior management has a responsibility to maintain practices consistent with those standards. Each company should clearly set out its code of conduct, ensure that it is understood by all employees, and conduct regular training on it. Companies should also develop policies to ensure that all conflicts of interest (related party transactions) are disclosed, and establish a register for such disclosures (CG Code Principle 7).

The company should establish a sound system of internal control that is designed to identify, assess, monitor, and manage risk, and to inform investors of material changes to the company's risk profile (CG Code Principle 10). Each company is to determine the material business risks it faces including operational, compliance, ethical conduct, reputation, financial reporting, and legal risks. The company's risk management policy should clearly define the roles and responsibilities of the board, audit or other board committee, management, and internal audit function. Management should develop, implement and review the company's risk management and internal control system, while the board should review its effectiveness at least annually. The company may wish to form a separate risk management committee to address these matters, but ultimate responsibility rests with the full board (CG Code Recommendation 10.1).

The Reserve Bank Requirements provide that each institution must establish and implement an in-house "Corporate Governance Policy" approved by the board (or by senior management in the case of a branch of a foreign institution). This should clearly define the authority and responsibility of the board, senior management, and internal and external auditors (para.4.0). The policy must address such matters as disclosures concerning ethics and other norms, governance structures, conflict of interest rules, audit, and codes of conduct. The ethics code should include provision for complaints handling, protection of whistleblowers, corruption and other illegalities, and the ability (which is not to be impeded) of employees to disclose matters to, or discuss them with, RBF. Each institution's policy is to be submitted to RBF (paras.4.1.3-4, 4.2.1, 4.3.1). The Reserve Bank monitors adherence to these policies as part of its regular banking supervision (para.5.1).

Under a separate policy statement, RBF requires licensed institutions to establish policies for operational risk management. These policies must be adopted by the board, documented, and communicated to all employees on a regular basis. Areas to be covered include internal audit, outsourcing (e.g. use of agents), and fraud risk. The institutions must establish structures and procedures to ensure compliance with risk management policies, including internal controls and internal audit of the control environment.[11]

International standard	Compliance by member country
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees. 4) Risk-based approach: • Individualized assessment of risks to the enterprise, including corruption risks. • Regular monitoring and re-assessment of corruption risks.	Per CG Code and RBF Policy Statements: 1) Internal control systems, and disclosure of them, encouraged on a "comply or explain" basis by CMU and mandated for financial institutions by RBF. 2) Internal control and risk management to address financial reporting. Oversight by audit committee. 3) Board ensures commitment and support across the company. Written commitments not required. 4) Risk assessment and risk-based definition of systems required.

Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements. 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations. 4) Require for third-party representatives, consultants, or agents: • Written contract, adherence to company ethics standards and anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	Per CG Code and RBF Policy Statements: 1) Corporate codes to address illegality, legal risks. 2) RBF requires internal ethics codes and risk management to deal with fraud and corruption. 3) Under the Crimes Decree, gifts may be presumed to be for corrupt purposes.[12] 4) RBF (BSPS No.16) requires risk management for outsourcing agreements, including company access to agent financial documents.
Enforcement, including sanctions for failure to comply.	Enforcement via regulatory authority of CMU and RBF.

4. Integrity of financial statements

A. Accounting

1. Financial records

Under the Companies Act[13] (art.149), every company must keep proper books of account (in English) with respect to all sums received and spent (and for what), all sales and purchases of goods, and all assets and liabilities. These records must be sufficient to give a true and fair view of the state of the company's affairs and to explain its transactions. The books of account must be kept for seven years and to be open to inspection by the directors. Any director failing to take all reasonable steps to ensure the company’s compliance, or wilfully causing the default, is liable to fines and imprisonment (the latter only if wilful).[14]

International standard	Compliance by member country
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	Books of account to be kept for 7 years. Method is not defined in detail.
Prohibitions (UNCAC 12(3), OECD Convention 8(1)), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	1) Falsification falls within true and fair requirement and IFRS (see below). Crimes decree (arts.152-153) penalizes falsification of documents. Also, Proceeds of Crimes Act prohibits falsifying documents produced in response to investigation.[15] 2) Early and intentional destruction prohibited. 3) through 6): No express prohibition, though these fall within true and fair requirement and IFRS (see below).

2. *Financial reporting requirements*

The Companies Act sets forth financial reporting requirements, while the Fiji Institute of Accountants (FIA, an IFAC member) issues the reporting standards and determines their application. The Act (arts.150-151) requires the directors of every company to produce an annual financial statement (balance sheet along with profit and loss account or income and expenditure account for non-profits) and present it to the AGM. A director of a company failing to take all reasonable steps to comply is liable to fines. Each such financial statement is to provide a true and fair view of the state-of-affairs of the company. More detailed accounting rules are provided in a schedule to the Act (Schedule 7). The Company Registrar may, upon application, or with the consent of a company's directors, modify any of the requirements as to the required content of the financial statement for the purpose of adapting them to the circumstances of the company. The true and fair requirement does not apply if the company has subsidiaries and it complies with the consolidated reporting rules of the Act. A director failing to take all reasonable steps to ensure compliance by the company with the provisions on the content of financial statements is subject to fines and imprisonment (the latter only if wilful).

Art.152 of the Act requires consolidated accounts for holding companies and subsidiaries, unless the company directors obtain the Registrar's approval of a waiver on the grounds that consolidation would be unreasonable. [16] Arts.153-156 provides further detail on the rules for consolidated reporting and the definitions of subsidiaries and holding companies. Foreign companies are in many cases (e.g. not a Commonwealth company, no application for exemption) required to submit financial statements in the same manner as domestic companies.

The FIA has adopted IFRS as of 2007, and made them mandatory for certain companies in Fiji Islands. IFRS are required for large or publicly accountable entities, defined as follows:

- public companies and those that are majority-owned by the government;
- banking and financial institutions along with insurance and brokerage entities;
- entities with annual group turnover or assets of at least FJD 20 million (USD 10.7 million[17]);
- other entities with annual turnover of at least FJD 5 million (USD 2.7 million) including those that are publicly accountable (e.g. having publicly issued debt or equity instruments), those that are more than 20% owned by any of the above entities, and government entities established under their own statute.

Other firms use IFRS for SMEs, which were adopted as of 2011. The IFRS and IFRS for SMEs largely replaced the Fiji Accounting Standards based on earlier IAS, although the latter appear to be used still for smaller companies that have not transitioned to either of the IFRS sets of rules. [18]

International standard	Compliance by member country
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) Publicly-accountable entities required to use IFRS. 2) Other companies to use IFRS for SMEs, or in some cases earlier Fiji standards based on IAS. 3) IFRS 10 requires disclosure of such off-balance-sheet activities.
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) IAS 37 requires such disclosure, but in practice normally does not compel disclosure of potential corruption prosecution or its effects. 2) Prohibition in Proceeds of Crimes Act.

B. Audit

1. Auditing requirements

FIA has adopted international standards in the audit area as well. The ISA were brought into force beginning in 2002, and have been replaced with updated versions, the latest being the clarified ISA issued by IAASB in 2009 and adopted in full by FIA beginning in 2011.[19] The requirements for company audits are addressed in the Companies Act and the corporate governance standards issued by CMDA (CMU) and RBF.

The Companies Act (arts.161-162) requires public companies[20] (and private companies with shares held by public companies or their subsidiaries) annually to appoint external auditors. As mentioned, companies are required to submit their financial statements (balance sheets) to the shareholders. Public companies must also submit annual returns to the Company Registrar, attaching copies of the financial statements approved by the board and certified by a company director and secretary, along with the audit reports and directors' reports (arts.130, 158). Company balance sheets must be signed on behalf of the board by two directors, and in the case of a bank, three directors (art.157). Any member (e.g. shareholder) of a company has the right to receive a copy of the financial statements with attachments 21 days before the general meeting at which the statements are to be reviewed (art.160). Failure to comply with any of these requirements makes the company and every officer in default liable to fines.

The auditor is to provide a report on all accounts and financial statements reviewed (Companies Act art.165, Eighth Schedule). The auditor has the right of access to the books, accounts, and vouchers of the company, and may demand from the officers of the company any necessary information or explanations. The auditor's report is to state whether the auditor received the information and explanations required, and also to provide an opinion as to whether proper books of account have been kept by the company, whether the financial statements are in agreement with the books of account, and whether the accounts give a true and fair view of the company's affairs (or the group's affairs in the case of consolidated accounts).

The corporate governance standards issued by CMDA (CMU) and RBF provide some further clarification. The CG Code (Recommendation 9.1) states that companies must appoint external auditors. It further advises that the roles, responsibilities and reporting channels of the auditors should be clearly defined, and that the external auditor should report directly to the audit committee.[21] The RBF requirements (BSPS No.7[22] and BSPS No.11, para.4.4.2) apply these standards as requirements for financial institutions.

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	Auditing controls are fairly comprehensive in principle.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	Per Companies Act: 1) Public companies required to have annual external audits. 2) Private companies are exempt if their voting members decide unanimously not to appoint an auditor (and the Registrar does not appoint an auditor for the company).
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	Audits are to be conducted using clarified ISA adopted by FIA as of 2011. These include ISA 240 and 250.
Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks. 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	1) Per Companies Act: Auditor to state opinion on whether accounts were properly kept, whether financial statements agree with account books and provide true and fair view. Internal controls overseen by audit committee, not required to be part of external audit (unless requested by RBF in connection with a financial institution, see below). 2) Financial reports to be signed by directors, not by CEO/CFO. Company officers required to cooperate with auditor, supply information and explanations as required.

2. Auditor reporting of improprieties

There appears to be no provision for external reporting by auditors generally. However, in the case of the financial sector, RBF's Banking Supervision Policy Statement No. 7 provides for direct communication between a bank's external auditor and RBF. The Statement refers to requirements in the Banking Act that bank financial statements must be audited, and that bank disclosures in response to RBF's normal and special information requests are also to be audited. Further, RBF may require a licensed institution to have its auditor provide a report on any relevant matters including the institution's compliance with statutory provisions or a review by the auditor of accounting systems and internal controls (para.3.5). The Policy Statement refers to a Banking Act requirement that an auditor (or former auditor) must disclose to RBF any information acquired in the course of an audit indicating that the institution is carrying on its business in a manner detrimental to the interests of its depositors or of its creditors (para. 3.6). In addition, the Reserve Bank may set up direct meetings with any auditor – without the institution's representatives being present – to discuss concerns, problems, or urgent matters (paras. 4.1.1 and 4.1.4). The matters reported or discussed could include fraud and corruption, though these issues are not expressly mentioned. Another RBF Policy Statement provides whistleblower protections to financial institution employees or directors who report policy violations to RBF.[23]

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	Internal reporting of fraud or illegality required by ISA 240 and 250.
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").	1) ISA 240 and 250 recommend external reporting of material problems, but only if required and protected by law. Banking Act and RBF Policy Statement require auditor reporting to, and discussions with, RBF on critical matters affecting bank regulatory compliance and protection of depositors. This could include corruption but not necessarily. 2) No explicit safe harbor, though communications required by Banking Act and Policy Statement are likely to be protected. Also, RBF BSPS No. 10 protects whistleblowers.

C. Professional standards and independence

The Fiji Institute of Accountants is the professional body responsible for the accreditation of accountancy professionals. The society has a membership of 720, of which around 30% are Chartered Accountants. The Institute is a registered member of IFAC. To practice professionally as an accountant, an individual must be registered with the Institute and have both the correct academic qualifications and practical experience (under a mentor). In order to be admitted as a full member an individual must have post-graduate qualifications, most commonly the Certified Practicing Accountants Australia training program. There are a range of small and medium-sized accounting firms, along with affiliates of the large international networks.[24] FIA bylaws require continuing professional education, with the minimum being 40 hours per year including structured and unstructured learning. FIA has adopted the current IFAC/IESBA Code of Ethics, supplemented by provisions included in the previous Fiji Code (the Supplementary Code of Ethics).[25]

The Investigation and Disciplinary Committees of the FIA are established by the Fiji Institute of Accountants Act[26] and drawn from FIA's membership. A range of enforcement processes and sanctions are provided to enforce professional and ethical standards. There is a requirement for independent review of audit practitioners. FIA has an independent Surveillance Panel responsible for quality review of audits of public interest entities (including all listed companies) and indirectly of the members undertaking those audits. FIA uses the services of independent professionals to review the quality of tertiary education being provided by those educational institutions from which the Institute principally draws its members (FIA Action Plan, pp.3-14).

The Companies Act (arts.161-164) provides the main standards for auditor appointment and independence, with further clarification given by the CMDA/CMU and RBF codes. A company's incumbent auditor is to be reappointed automatically unless deemed disqualified, or she/he has been replaced by resolution of the company, or the auditor has given notice in writing of a wish not to be reappointed. An incumbent auditor must receive advance notice of a resolution not to reappoint the auditor, and she/he must have the opportunity to make written representations in response and have them presented to the AGM. A person may not be appointed a company auditor unless the individual and every partner in the firm holds a certificate of public practice issued by the Fiji Institute of Accountants. The following may not be appointed: an officer or employee of the audited company (or a business partner of such person), a corporation, and anyone disqualified from serving as auditor of an affiliated company within a corporate group. Failure to comply is subject to fines for the company and the auditor.

The CG Code (para.9.1) further provides that any non-audit work by the company auditor must not cause any compromise of the auditor's independence. The RBF Requirements (para.4.4.2) add that the auditor "must be independent (and seen to be independent)" of the audited institution's internal auditors and any outsourced activities of the institution. No person having an interest in any institution other than as a depositor, and no director, employee or agent of any institution is eligible for appointment. An auditor who subsequently acquires such an interest or relationship must cease serving as auditor.

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) FIA defines standards for certification, including education, experience, continuing training. 2) FIA has adopted IFAC/IESBA Code of Ethics.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	Per Companies Act and Corporate Governance Code and RBF standards: 1) Appointment and removal by resolution, automatic reappointment otherwise. 2) Auditors advised to prevent non-audit work from compromising independence. 3) No provision. 4) No auditor may be employee or director. No bank auditor may have financial interest or agent relationship. 5) No provision.
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) and 2): FIA determines qualification and continuous education requirements. 3) FIA, a professional membership body, supervises audit quality, using outside consultants in many cases. 4) FIA imposes professional discipline per FIA Act.

D. Enforcement

The Companies Act provides the basic enforcement sanctions. Any director failing to take all reasonable steps to ensure the company's keeping of proper books of account, or wilfully causing non-compliance, is liable to fines up to FJD 1,000 (USD 535) and imprisonment (if wilful) for up to one year (art.149). The same penalties apply in the case of failure to issue proper and complete financial statements or consolidated statements (arts.150, 152). Maximum fines are in many cases set at FJD 100 (USD 54), including for circulating an unsigned balance sheet or one without the auditor's and director's reports attached (the fine applies to the company and to officers in default, arts.157-8). A disqualified person accepting appointment as a company auditor is subject to fines up to FJD 400 (USD 214), as is the audited company and every officer in default (art.164). In addition, the Crimes Decree (arts. 160-161) provides for up to seven year's imprisonment for certain offenses involving false corporate documents.

The FIA Act (art.32) stipulates that the FIA Disciplinary Committee has authority (with approval of the chair in most cases) to remove a professional member from the FIA register, to suspend a member for up to five years, to impose a fine up to FJD 200 (USD 107), to censure a member, or to order the member to pay investigative costs. Persons engaged in unauthorized practice are subject to fines up to FJD 400 (USD 214) and imprisonment up to one year – and double penalties for each subsequent offense (art.41).

International standard	Compliance by member country
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2): Provisions on accounting and audit provide tools for combating bribery. Whether they are fully used for this purpose is uncertain.
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Sanctions include fines and imprisonment, though most fines are quite low. 2) Some penalties apply to companies. 3) Effectiveness of enforcement is not clear. FIA is a membership body.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Sanctions include fines and imprisonment, though most fines are quite low. 2) Some penalties apply to companies. 3) Effectiveness of enforcement is not clear. FIA is a membership body, and neutrality of courts has been questioned.

5. Conclusion and recommendations

A. General efforts to prevent corruption involving the private sector

In Fiji Islands, FICAC plays the lead role in supporting public-private coordination to combat private sector-related corruption. NGOs such as Transparency International-Fiji Islands are active, but focus largely on the public sector. Mechanisms such as sentence mitigation to encourage self-reporting, and integrity pacts to couple private sector commitments to good governance with self-policing, are underutilized.

Recommendations

1) Support FICAC in reaching out more consistently to private sector institutions such as corporate groups and chambers of commerce to train and raise awareness about the means to deter private sector corruption.
2) Make sentence-mitigation available as a means to encourage self-reporting of corruption.
3) Support private sector integrity pacts, perhaps focusing on the tourism sector and related industries.

B. Internal controls

Corporate governance principles issued by the banking and capital markets regulators provide the main standards here, backed up by the regulators’ authority over their respective markets. This is reasonable in the sense that financial sector and capital market entities are the ones with most urgent need for internal controls, and are usually the best able to maintain them. But this also leaves a significant segment of large or public companies without legal requirements for internal audit. Existing internal audit standards are fairly minimal, while the audit committee norms cover more issues such as membership and reporting relationships. The provisions on ethics codes, risk management, and internal control are the most developed and include a number of best practice provisions such as anti-corruption norms and duties by the board to set a “tone at the top” and ensure training and reinforcement throughout the organization.

Recommendations

1) Incorporate the CMDA/CMU and RBF standards into mandatory rules for a wider range of companies. This could include all publicly-accountable companies or all those subject to external audit.[27]
2) Develop the CG Code and RBF standards further, including, for example, more robust internal audit standards (review internal controls and legal compliance), an anti-corruption complaints and remediation role for the audit committee, and internal control provisions requiring written staff commitments and rules on gifts, agents, and other areas of vulnerability.[28]

C. Integrity of financial statements

Fiji Islands has reasonably well-developed standards in this area, especially for a country of less than one million inhabitants. FIA has adopted both IFRS and ISA, and it maintains fairly high standards for accounting and audit professionals. The range of companies that must have external audits is somewhat limited. Auditor reporting of fraud and corruption is provided for only in the financial sector, under RBF standards. The rules on auditor independence are not very strict, although this is in a sense understandable given the limits to Fiji Islands' population of relevant professionals. As in many other cases, although some offenses are subject to prison terms for individuals, the fines applicable to companies, officers, and professionals are well below deterrent levels.

Recommendations

1) Incorporate into record-keeping rules explicit prohibitions on manipulations such as off-the-books arrangements associated with the disguising of corruption.
2) Require signature/certification of all financial statements by company CEOs and CFOs. Also, adopt an explicit prohibition on company officers' attempts to obstruct or manipulate an external audit.
3) Broaden requirement of auditor reporting to external authorities to include CMU and Company Registrar. Adopt an explicit safe harbor provision to protect auditors who report.
4) Tighten auditor independence and conflict of interest rules. Consider supplementing FIA with an oversight and enforcement body independent of the accounting and audit profession.
5) Increase fines for all offenses and index them for inflation.

Fiji Islands Laws, Regulations, Policy Documents Referenced:

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Prevention of Bribery (Promulgation No. 12 of 2007), Interim Government of the Republic of the Fiji Islands, http://www.track.unodc.org/LegalLibrary/pages/LegalResources.aspx?country=Fiji.

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Reserve Bank of Fiji (2007), Banking Supervision Policy Statement No.10: *Fit and Proper Requirements for Licensed Financial Institutions in Fiji, Notice to Banks and Credit Institutions Licensed Under the Banking Act, 1995,* http://www.reservebank.gov.fj/docs/Banking%20Superision%20Policy%2010_Fit%20&Proper.pdf .

Reserve Bank of Fiji (2007), Banking Supervision Policy Statement No. 11: *Minimum Requirements on Corporate Governance for Licensed Financial Institutions, Notice to Banks and Credit Institutions Licensed Under the Banking Act, 1995,* http://www.reservebank.gov.fj/docs/Banking%20Supervision%20Policy%2011_Corp%20Gov.pdf

Reserve Bank of Fiji (2010), Banking Supervision Policy Statement No. 16, *Minimum Requirements for the Management of Operational Risk for Licensed Financial Institutions in Fiji*, http://www.reservebank.gov.fj/docs2/Banking%20Supervision%20Policy%20Statement%20Number%2016.pdf.

NOTES

[1] Formerly Capital Markets Development Authority (CMDA) .

[2] Sources for this and the preceding paragraph: http://www.dfat.gov.au/geo/fiji/fiji_brief.html; *Doing Business in Fiji: 2013 Country Commercial Guide for US Companies*, US Commercial Service, p.32, 36, 41, http://www.buyusainfo.net/docs/x_1094072.pdf,http://www.state.gov/r/pa/ei/bgn/1834.htm.

[3] http://www.track.unodc.org/LegalLibrary/pages/LegalRsources.aspx?country=Fiji.

[4] Prevention of Bribery(Promulgation No. 12 OF 2007), Interim Government of the Republic of the Fiji Islands, arts.3-9, http://www.track.unodc.org/LegalLibrary/pages/LegalResources.aspx?country=Fiji.

[5] http://www.ficac.org.fj/; *FICAC Annual Report 2012, Id.*

[6] http://www.transparencyfiji.org/Projects.aspx.

[7] The sources of all standards are provided in footnotes to the tables presented in the section of the Review entitled *International Standards for Country Reports.*

[8] Capital Markets Development Authority (2008),*Corporate Governance Code for the Capital Markets*, http://www.cmda.com.fj/docs/Corporate%20Governance%20%20Principles%20.pdf.

[9] *The Capital Markets Corporate Governance Principles Reporting Guidelines for Listed Companies and Licensed Intermediaries*, http://www.cmda.com.fj/docs/Guidelines%20for%20Reporting.pdf. The South Pacific Stock Exchange (SPSE) is the front line regulator for listed companies, and enforces the CG Code requirements. Government comments.

[10] Reserve Bank of Fiji (2007), Banking Supervision Policy Statement No. 11, *Minimum Requirements on Corporate Governance for Licensed Financial Institutions*, Notice to Banks and Credit Institutions Licensed Under the Banking Act, 1995, http://www.reservebank.gov.fj/docs/Banking%20Supervision%20Policy%2011_Corp%20Gov.pdf. RBF conducts supervision and ensures that institutions it licenses comply with the CG Code requirements.

[11] Reserve Bank of Fiji (2010), Banking Supervision Policy Statement No. 16, *Minimum Requirements for the Management of Operational Risk for Licensed Financial Institutions in Fiji*, http://www.reservebank.gov.fj/docs2/Banking%20Supervision%20Policy%20Statement%20Number%2016.pdf.

[12] Crimes Decree 2009 (Decree No. 44 of 2009), arts.149-151, http://www.fiji.gov.fj/getattachment/604e31fc-c7b1-41a0-9686-71377917b6eb/Decree-No-44---Crimes-Decree-2009-(pdf).aspx. Government comments.

[13] Companies Act, Laws of Fiji [Rev. Ed. 1985] (Cap.247), http://www.paclii.org/fj/legis/consol_act/ca107/.

[14] Government notes that there are other laws requiring proper and complete record keeping and books of accounts and audits, including the Banking Act, Insurance Act, and Trust Accounts Act (for Legal Practitioners).

[15] Fiji Proceeds of Crime Act, 1997 (as amended), art.54. http://www.oecd.org/site/adboecdanti-corruptioninitiative/39830464.pdf. Government comments.

[16] I.e. Registrar may grant waiver "on the ground that the result would be harmful or on the ground of the difference between the business of the holding company and that of the subsidiary."

[17] All currency conversions at interbank rate as of Mar.15, 2014, http://www.oanda.com/currency/converter/.

[18] http://www.commonwealthofnations.org/sectors-fiji/business/accountancy_audit_and_tax/; http://www.fia.org.fj/Legislation/FIA-By---Laws.aspx; Action Plan Developed by Fiji Institute of Accountants, p.15, http://www.ifac.org/sites/default/files/compliance-assessment/part_3/201303%20Fiji%20FIA.pdf.

[19] http://www.fia.org.fj/Legislation/FIA-By---Laws.aspx; FIA Action Plan, p.8.

[20] That is, those not defined as private companies in art.32 of the Act. That definition includes companies that restrict share transfer, limit the number of members to 50 or below, and prohibit public offer of shares or debentures.

[21] Also, CMDA in 2010 issued a further policy statement, *Role of External Auditors in the Supervision of Licensed Persons*, http://www.cmda.com.fj/index2ef0.html?Page=readNews&which=4&newsId=191.

[22] Reserve Bank of Fiji (2001), Banking Supervision Policy Statement No. 7, *Notice to Financial Institutions Licensed under the Banking Act 1995 and their External Auditors: Role of External Auditors in the Supervision of Licensed Financial Institutions*, http://www.reservebank.gov.fj/docs/Banking%20Supervision%20Policy%207_Role%20of%20EA.pdf.

[23] Reserve Bank of Fiji (2007), Banking Supervision Policy Statement No.10, *Fit and Proper Requirements for Licensed Financial Institutions in Fiji*, Notice to Banks and Credit Institutions Licensed Under the Banking Act, 1995, http://www.reservebank.gov.fj/docs/Banking%20Superision%20Policy%2010_Fit%20&Proper.pdf.

[24] http://www.commonwealthofnations.org/sectors-fiji/business/accountancy_audit_and_tax/.

[25] http://www.fia.org.fj/Legislation/FIA-By---Laws.aspx.

[26] Laws of Fiji [Rev.Ed.1985] Cap. 259, Fiji Institute of Accountants, http://www.paclii.org/fj/legis/consol_act/fioaa318/.

[27] Government reports that a new companies decree is expected to address this point, and that many businesses in Fiji are small or medium family-run firms – applying stringent corporate governance rules to them would be of little benefit, if not unworkable.

[28] Government points out that RBF policies outline only minimum requirements, and that companies are motivated to provide for internal controls and other components of good corporate governance as a result of the provisions on corporate criminal liability in the Crimes Decree (arts. 51 – 56).

Hong Kong, China

1. Introduction

The reputation of Hong Kong, China[1] as one of the world's most open, business-friendly, and corruption-free economic centers has continued to grow since the 1997 handover. The region's Basic Law enshrining the "one country, two systems" principle, provides for a high degree of autonomy under the sovereignty of the People's Republic of China, and for preservation of its economic system – including its currency. The Chief Executive of the HKSAR is the head of the HKSAR and governs together with an elected Legislative Council and an independent judiciary. China's National People's Congress Standing Committee has the power of final interpretation of the Basic Law. Hong Kong, China is a dynamic, increasingly service-based economy, a major corporate and banking center, and a conduit for China's exports, while employing millions of workers in the neighboring Chinese province of Guangdong.[2]

The region's Independent Commission Against Corruption (ICAC) has been a highly successful watchdog and enforcer, providing an international best practice model and making the city an example of good governance. In Transparency International's 2012 Corruption Perceptions Index, Hong Kong, China ranked 14th, above Japan, the UK, and the US. However, increasing interaction with the mainland is seen as two-sided, creating opportunities to spread Hong Kong, China's anti-corruption experience across China, but also posing threats to the city's clean image. In recent years, questions of probity have arisen within the region's government, forcing a high-profile resignation and requiring ICAC to investigate its own former chief.[3] The regional government states that these are isolated cases, and that Hong Kong, China's zero tolerance policy on corruption remains in effect.

The economy of Hong Kong, China is highly dependent on international trade and finance, and increasingly integrated with that of mainland China through trade, tourism, and financial links. The region has been designated as an offshore center for internationalization of the Chinese renminbi (RMB). The city has also established itself as the premier stock market for Chinese firms seeking to list abroad. In 2012, mainland Chinese companies constituted about 46.6% of the firms listed on the Hong Kong Stock Exchange and accounted for about 57.4% of the Exchange's market capitalization.[4] The free movement of capital has accelerated the city's development as an international commercial and financial center, bolstered by effective legal-regulatory institutions and respect for the rule of law.

2. General efforts to prevent corruption involving the private sector[5]

Hong Kong, China has a wealth of corruption prevention initiatives, most of them led by or involving ICAC. The Commission uses its investigative, preventive, and outreach authority to help ensure integrity and accountability in the private sector. The Independent Commission Against Corruption Ordinance[6] (sec.12) requires ICAC to instruct and assist organizations in eradicating corrupt practices, to educate the public against the evils of corruption, and enlist public support in combating corruption. ICAC maintains a 24-hour hotline to facilitate reporting of corruption by the general public as well as organizations in both the public and private sectors. In addition, ICAC receives complaints by post, and has a network of regional offices throughout Hong Kong, China to receive enquiries and corruption complaints. All these channels are publicly advertised in various media.

On the enforcement front, ICAC takes a proactive approach to its mission, maintaining extensive contacts in the private sector to exchange information and facilitate cooperation. In this connection, liaisons have been established with all major banks, insurance companies, accountancy firms, professional bodies and other private entities in Hong Kong for cooperation in the investigation of corruption offences. Further, if any offender (whether an individual or organization) provides assistance to the authorities in (i) the investigation and prosecution of crimes, (ii) locating and seizing lost property, or (iii) tracing and recovering proceeds, this aid is to be considered as a mitigating factor in proceedings against the offender. There are no sentencing guidelines addressing this matter, and any mitigating effect is determined case-by-case.

Every year, ICAC conducts programs to enhance corruption awareness and prevention in selected sectors, in partnership with the relevant associations and regulators (e.g. the program for the banking industry was organized with the Hong Kong Monetary Authority (HKMA), the Hong Kong Association of Banks, the Hong Kong Institute of Bankers, and others). ICAC maintains a corruption prevention network with some 70 SME chambers of commerce and trade associations, leveraging their support to disseminate anti-corruption messages, advertise corruption prevention services, and hold conferences on topics of interest to their 40,000 member companies. The deliverables of these programs usually include corruption prevention or best practices guides, and educational tools (e.g. training videos). ICAC has also been working closely with the professional bodies of accountants, architects, surveyors, financial institutions, estate agents, and others to organize tailor-made professional ethics courses with a corruption prevention focus. In addition, ICAC has an Advisory Services Group that provides corruption prevention advice to private sector organizations upon request.

With the support of six major chambers of commerce, ICAC established the Hong Kong Ethics Development Centre (HKEDC) in 1995 to promote business ethics in the private sector. The Centre approaches private organizations, trade and professional bodies to encourage them to take steps to safeguard integrity, such as formulating/reviewing company codes of conduct, tightening internal control systems, incorporating anti-corruption elements into professional licensing requirements, and organizing ethics training for their employees/members. As for the accounting and audit professions, HKEDC sits on the Ethics Committee of Hong Kong Institute of Certified Public Accountants (HKICPA). ICAC provided input on the Code of Ethics for Professional Accountants from the corruption prevention perspective. HKEDC has also organized seminars on compliance and professional integrity for practitioners in collaboration with HKICPA and local branches of international professional bodies.

The real estate industry provides a good example of a sector-specific initiative. ICAC has jointly launched a program with the Estate Agents Authority (EAA) to work with real estate firms and associations to formulate and review company codes of conduct and internal control systems, and to assist in organizing workshops and staff activities on anti-corruption themes. [7] EAA issues Code of Ethics and Practice Circulars, and jointly with ICAC issues a Best Practice Checklist. [8] Separate codes and standards maintained by regulators and self-regulatory organizations (SROs) in other sectors are discussed in the section following.

Further, all government sector contracts now contain probity clauses prohibiting contractors from committing bribery and collusion, and requiring them to abide by tendering and contract requirements for preserving confidentiality and declaring conflicts of interest. Failure of the contractors to comply with these probity clauses may incur criminal liability as well as result in their tenders/contracts being invalidated or terminated.[9]

International standard[10]	Compliance by member country
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	ICAC works with sector associations and companies on corruption awareness, prevention, and detection.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) ICAC provides a corruption reporting hotline and actively reaches out to the private sector to encourage prevention and reporting. 2) Sentence mitigation is available for offenders, according to ICAC, but is not formalized in sentencing guidelines.
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	ICAC: 1) Consults with companies and associations on ethics codes, internal controls, and related matters to prevent corruption. 2) Holds conferences and workshops on corruption issues with sector associations, SMEs, professional bodies, and others. 3) Works with associations, regulators, and SROs on ethics and corporate governance codes and practices.
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	Although standard-setting and codes of conduct are quite prevalent, the enforcement mechanism of the integrity pact (i.e. self-policing of standards by private sector often with civic partnership) does not appear to be used to any great extent.

3. Internal controls

A. Internal audit

There are no legal mandates or uniform standards for internal auditing in Hong Kong, China. However, regulatory bodies in some cases recommend or require an internal audit function in companies under their supervision. Thus, HKMA issued a module on internal audit in its Supervisory Policy Manual (SPMs), stating that banks and deposit-taking institutions authorized under the

Banking Ordinance ("authorized institutions") are expected to establish internal audit systems appropriate for the size, nature, and scope of their operations.[11] This is virtually mandatory, and it is considered in the granting of authorization and ongoing supervision of each institution. In the SPM module, internal auditors are expected to provide an independent assessment of such matters as the following:

- compliance with internal policies as well as relevant laws, regulations, and supervisory guidelines;
- the reliability and timeliness of financial and management information, and of the relevant information systems;
- the accuracy of accounting records and financial reports;
- the efficiency of operations through testing of specific internal control procedures; and
- the effectiveness of the systems and processes for risk management and control, including safeguarding of assets and fraud detection and prevention.

The SPM module outlines the relationship of the internal audit function with the board and senior management, suggesting that authorized institutions should establish audit charters to structure the relationships so that internal auditors can be objective and professional, and be provided with sufficient resources. Operation should be based on a set of audit plans, programs, and procedures (paras. 2.4, 3.2-3.4, 4.2). For insurance companies, the Office of the Commissioner of Insurance (OCI) issued a guidance note on corporate governance requiring insurance companies to have their internal control systems in place to oversee the proper conduct of their business and affairs.[12]

Internal audit is reported to play an increasingly important role in Hong Kong, China companies, with nearly all large, listed companies using an in-house internal audit department, outsourcing the function, or using a combined approach. All companies in the Hang Seng Index have established an internal audit function, while 98% of Hang Seng Composite Index companies have done so. The HSCI companies who lacked an internal audit group cited as the reason either limited resources, lack of complexity in company accounts (hence no need for it), or the proximity of senior management to their operations.[13] Further, the region does have an active IIA affiliate,[14] hence sufficient demand for internal audit expertise to support a professional organization.

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	Internal audit not subject to legal requirement or mandatory standards. Insurance regulatory guidelines encourage internal audit, and bank regulators expect authorized institutions to maintain internal audit functions appropriate to the size, nature and scope of their operations. Listed companies generally conduct internal audit.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect "illegal acts" in the books and records of companies, including bribery and other forms of corruption.	1) and 2): No official standards applied to internal audit practice. IIA-Hong Kong promotes international best practice standards, including detection of illegalities and corruption.
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	1) to 4): No legally-mandated standards, but voluntary IIA standards cover these matters. HKMA guidelines also strongly recommend internal audit for authorized institutions. OCI has provided similar guidance for insurance companies. Safeguards against corruption not explicitly provided.

B. Audit committee

There is no general requirement of a supervisory or audit committee, including in the Companies Ordinance. Listed companies, however, must establish an audit committee under the Listing Rules and Corporate Governance Code[15] issued by Hong Kong Exchanges and Clearing Limited (HKEx). Listing Rules 3.21 to 3.23 require every listed entity to establish an audit committee comprised of non-executive directors. A majority must be independent, and must include one member with professional qualifications in accounting or a related area. The committee must have terms of reference clearly defining its authority. If no audit committee is established, the issuer must provide a written explanation to the Exchange, i.e. “comply or explain.” Additional guidelines are provided by the Corporate Governance Code (sec. C.3), dealing mainly with the audit committee’s terms of reference. The latter should include these functions:

- Recommend the appointment, reappointment and removal of the external auditor;
- Review and monitor the external auditor’s independence and objectivity, and the effectiveness of the audit process;
- Monitor the integrity of financial statements, annual report, accounts and accounting policies;
- Review financial controls, internal control and risk management systems;
- Where an internal audit function exists, ensure co-ordination between the internal and external auditors;
- Review arrangements for employees to raise, in confidence, concerns about possible improprieties in financial reporting, internal control or other matters.

A recent study found that the proportion of Hong Kong, China firms complying with the Corporate Governance Code in 2013 had dropped to its lowest level since the Code was introduced in 2006.[16] In addition to the Code, HKMA requires that each locally-incorporated authorized institution should have an audit committee according to the SPM module on corporate governance. This module is a statutory guideline issued by HKMA under section 7(3) of the Banking Ordinance setting out the minimum standards that it expects locally-incorporated authorized institutions to adopt in respect of their corporate governance. Failure by an authorized institution to adhere to these standards may raise HKMA queries of whether the institution continues to satisfy the minimum criteria for authorization under the Banking Ordinance.[17]

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	1) No general requirement, but listed companies must have audit committees per Listing Rules. HKMA: Locally-incorporated authorized institutions should establish audit committees per HKMA's SPM modules on corporate governance and internal audit function (and insurance companies should have them per OCI guidelines). 2) Listing Rules/HKMA's SPM modules: all committee members to be non-executive and a majority to be independent. The Listing Rules also require one member to have accounting or similar credential. (OCI: similar, with majority to have financial/ accounting expertise.)
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers, employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	Per recommendations of Corporate Governance Code (listed companies), HKMA SPM modules (authorized institutions): 1) Audit committee to monitor all aspects of accounting and audit (internal and external), and review accounts and financial reports. 2) Committee to review and monitor internal controls. HKMA (authorized institutions): For (1) and (2), audit committee receives audit reports and ensures that senior management takes timely corrective action to address control weaknesses, non-compliance with policies, laws and regulations, etc. 3) No provision. 4) No express reference to corruption as such. (OCI: insurance companies to have formal procedures to identify potential suspicious transactions.) 5) Provide confidential channel for employee concerns about internal control, financial reporting, etc. No explicit reference to corruption.

C. Internal control and compliance systems

There are no laws of general application expressly requiring companies in the private sector to establish internal control systems. However, the Companies Ordinance[18] contains provisions relating to fair dealing by directors, particularly in situations in which a director is perceived to have a conflict of interest. It requires disclosure and member approval of transactions involving directors or their connected entities, as well as disclosure by directors of material interests in company transactions. Directors are subject to a statutory duty of care, skill and diligence. Directors and employees are also subject to duties under the common law to act in the interests of the company, to avoid conflicts of interests, and to avoid making secret profits. Further, there are standards and codes relevant to the establishment of internal control systems that are applicable to specific types of companies. (Also, OCI guidelines make similar provisions, which are legally binding for insurance companies).

The Corporate Governance Code issued by HKEx (sec.C.2) advises the board of any listed company to ensure that the company maintains sound and effective internal controls. The directors should annually review the effectiveness of the company's (and subsidiaries') internal control system and report this to shareholders in their Corporate Governance Report. The review should cover all material controls, including financial, operational and compliance controls and risk management functions. The annual review should, in particular, consider any changes in the nature and extent of significant risks, the scope and quality of management's ongoing monitoring of risks, significant control failings or weaknesses that have been identified, and prospective material impacts on the issuer's financial performance.

Authorized institutions, according to the Banking Ordinance,[19] must have in place adequate systems of control and carry on their business with integrity, prudence, and professional competence. This includes having an effective system to combat fraud, corruption, and money laundering. The Board and senior management of an authorized institution should cultivate a culture emphasizing high ethical standards at all levels of the institution, and establish policies and procedures to ensure its compliance with ethical values. Internal controls and codes of conduct are further detailed in HKMA's SPMs setting out the HKMA's supervisory policies and practices, i.e. the minimum standards that authorized institutions are expected to attain in order to satisfy the requirements of the Banking Ordinance and recommendations on best practices that authorized institutions should aim to achieve. These include:

- SPM CG-1[20] (secs.2.2, 2.4, 2.6) advising the board to identify and communicate throughout the organization a set of professional standards and values that promote responsible ethical behavior and guide officers and staff in the discharge of their duties. The board and senior management should adopt key risk management policies (including the prevention of money laundering) and oversee management in developing policies and practices to manage risk.
- SPM CG-3[21] (secs.1.1, 2.1, 3.7), requiring every authorized institution to submit its code of conduct (and any changes to it) to HKMA. Minimum standards are recommended for the content of such a code, along with elements of an effective system for enforcing the code – including the designation of an officer (e.g. compliance officer) to deal with matters relating to code of conduct. In addition, institutions are expected to report matters that could give rise to fraud, corruption or other illegal activities to HKMA and other authorities as soon as practicable.
- SPM CG-6[22] (secs.5.3-5.4), stating that authorized institutions should ensure that integrity and professional ethics are integrated into their corporate culture, and that there are clearly defined procedures for investigating any apparent instances of unethical behavior on the part of employees.

Standards on internal control and corporate ethics have also been adopted for the securities and insurance industries. Under the Securities and Futures Ordinance (SFO)[23], the Securities and Futures Commission (SFC) has published a Code of Conduct[24] for regulated intermediaries and their representatives. The Code states, for example, the following duties of regulated intermediaries:

- Implement measures appropriate to ensuring compliance with the law, regulations, and codes that apply (para. 12.1).
- Be familiar with the Prevention of Bribery Ordinance (POBO)[25] and follow related guidance issued by the ICAC. POBO prohibits agents (e.g. employees) from soliciting or accepting certain advantages without the permission of the principal (e.g. employer) when conducting the principal's business (para.2.4).
- Establish internal control procedures and financial and operational capabilities to protect operations, clients, and other intermediaries from financial loss arising from theft, fraud, and professional misconduct (para. 4.3).
- Report breaches of law and regulation to SFC immediately, providing documents and details (para. 12.5(a)).

Further SFC guidance is provided in the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission (ICG).[26] This covers such matters as management responsibility for internal control, effective lines of responsibility and communication, appropriate staff training to ensure compliance with internal control policies, compliance officers, and compliance reviews. Comparable guidance is provided for insurance companies by the Insurance Authority's Guidance Note on the Corporate Governance of Authorized Insurers.[27]

The SFC instruments cover a range of specific issues that are often related to corruption:

- *Control of cash and assets:* Effective procedures should be established to protect the firm's and its clients' assets from theft, fraud and other acts of misappropriation. In particular, the authority of the firm and its staff to acquire, dispose of and otherwise move or utilize the firm's or its clients' assets should be clearly defined, and reliable audit trails maintained, to enable the firm to prevent, detect and investigate suspected improprieties (ICG Part VII, para.9).
- *Risk management:* Effective policies and procedures should be maintained to ensure the proper management of risks to which the intermediary and its clients are exposed. Comprehensive reviews should be conducted at suitable intervals, and wherever there is significant change in the business, to ensure that the firm's risk of suffering losses due to control failures is kept within acceptable limits (ICG Part VIII, para.4).
- *Gifts and bribes:* The firm should clearly define parameters in relation to the acceptance by staff members or the firm of gifts, rebates, or benefits-in-kind from clients or other business contacts. These include the circumstances under which acceptance is permitted and approval required (ICG Appendix, para.5).
- *Agents:* An intermediary should ensure that any person it employs to conduct business is fit and proper and otherwise qualified, and that it has adequate resources to supervise such person diligently and does so in fact (Code of Conduct, paras. 4.1-4.2).

International standard	Compliance by member country
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees. 4) Risk-based approach: • Individualized assessment of risks to the enterprise, including corruption risks. • Regular monitoring and re-assessment of corruption risks.	General requirements for directors in Companies Ordinance: fair dealing, due diligence, disclosure of transactions involving potential conflicts of interest. Sector-specific standards set by regulators: 1) Listed companies to report internal controls and codes to shareholders. HKMA: Authorized institutions to report internal controls and codes to HKMA, along with any changes. (Insurance companies to submit information on internal controls upon request of OCI) 2) Testing of financial reporting controls expected of intermediaries regulated by SFC. 3) HKMA's SPM expects authorized institutions to establish adequate internal control guidelines and educate staff. 4) Intermediaries regulated by SFC encouraged to adjust controls in light of risk measurement and review. (OCI: insurance companies should review internal controls periodically.)
Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements. 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations. 4) Require for third-party	1) Listed companies, authorized institutions (HKMA), SFC-regulated intermediaries, insurance companies: guidelines for all require adherence to laws and regulations applicable to their business. 2) to 4): SFC-regulated intermediaries advised to know POBO, follow ICAC guidance, and adopt controls and compliance measures on agents, commissions, and gifts. (Insurance industry code: ensure that all employees and agents are aware of POBO rules and can

representatives, consultants, or agents: • Written contract, adherence to company ethics standards and anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	deal with potential conflicts of interest).
Enforcement, including sanctions for failure to comply.	Internal control provisions are mainly non-statutory codes that can be used in regulatory approvals and supervision. SFC (and OCI) penalties include fines, reprimands, prohibitions, suspensions and revocations of licenses. Failure to comply with relevant Companies Ordinance provisions is subject to prosecution.

4. Integrity of financial statements

A. Accounting

1. Financial records

Under the Companies Ordinance, every company is required to keep proper accounting records – i.e. sufficient to show and explain the company's transactions, to disclose with reasonable accuracy the company's financial position and financial performance, and to enable the directors to ensure that the financial statements comply with the statutory requirements. The accounting records must contain daily entries of all sums of money received and spent, and for what purpose, as well as a record of the company's assets and liabilities (section 373). If the accounting records are kept otherwise than by making entries in a bound book, the company must take adequate precautions to guard against falsification and take adequate steps to facilitate the discovery of falsification (section 376). The records must be open to inspection by directors at all times, or if the records are kept outside Hong Kong, China, accounts and returns must be sent at six month intervals sufficient to enable the directors to ensure that the financial statements comply with the Ordinance. The accounting records must be kept for seven years. Except for companies that are qualified to prepare simplified accounts, the financial statements must give a true and fair view of the financial position and financial performance of the company for the financial year. Any company director who fails to take all reasonable steps to secure the company's compliance with the above requirements commits an offense and is liable a fine, and if the director wilfully fails to do so, she/he is liable to fines and imprisonment. A person who knowingly or recklessly makes, in financial statements, a statement that is misleading, false or deceptive in any material particular is liable to fines and imprisonment (section 895). The use of a false document knowing it to be false, with intent to induce its acceptance (to a person's prejudice) is an offense under criminal law.[28]

International standard	Compliance by member country
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	Per Companies Ordinance: Form and method of record-keeping broadly defined. Retention period of 7 years.
Prohibitions (UNCAC 12(3), OECD Convention 8(1)), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	1) and 2): Prohibition of falsification, improper destruction, other manipulations per criminal law, Companies Ordinance. False accounting, using false instruments and misleading the principal (e.g. employer) with materially false information on any receipt, account or other document prohibited by Theft Ordinance, Crimes Ordinance, and POBO. 3) through 6): Covered by "true and fair" criterion, and rules against falsification.

2. *Financial reporting requirements*

All Hong Kong, China-incorporated companies are required to prepare, and have audited, annual financial statements that comply with the accounting standards issued or specified by the Hong Kong Institute of Certified Public Accountants (HKICPA) and provide a true and fair view of the financial position and performance of the company. Holding companies are required to prepare consolidated financial statements that include subsidiaries. Certain types of companies – generally, small private or guarantee companies or holding companies of such firms falling below a size threshold – are permitted to prepare simplified accounts that need not comply with the “true and fair view” requirement.[29] An SME (as defined in IFRS for SMEs) has the option to adopt the HKFRS for Private Entities, which is nearly identical to the IFRS for SMEs, or the Hong Kong Small and Medium-Sized Entity Financial Reporting Framework and Financial Reporting Standard.

HKICPA is the body authorized by law to promulgate (and enforce) financial reporting, auditing and ethical standards for professional accountants in Hong Kong, China according to the Professional Accountants Ordinance.[30] Financial reporting standards issued by the HKICPA are thus legally authoritative. Hong Kong Financial Reporting Standards (HKFRS) have been fully converged with International Financial Reporting Standards (IFRS) from January 2005.[31] Included in these standards is a fully convergent version of IAS 37, requiring disclosure of material contingent liabilities.[32] The standard of materiality, i.e. affecting economic decisions based on the financial reports, could require the reporting of potential corruption-related liabilities. (HKICPA confirms that, if prospective corruption liabilities are material contingencies, they would need to be reported by the auditor.[33])

The accounts of a foreign company that is publicly traded in Hong Kong are required to conform to HKFRS or IFRS.[34] An issuer from the People’s Republic of China may use the Chinese Accounting Standards for Business Enterprises, and an overseas issuer that has a secondary listing on the Hong Kong Exchange may apply US Generally Accepted Accounting Principles.

International standard	Compliance by member country
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) All Hong Kong, China-incorporated companies are required to comply with the accounting standards issued or specified by HKICPA, which are fully converged with IFRS. Overseas companies have further options including IFRS. 2) Simplified standards available to private and medium-small firms. 3) Holding companies to produce consolidated reports including subsidiaries, related transactions.
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) HKFRS (IAS 37) requires disclosure of material contingent liabilities. This could include corruption-related liabilities, but in international practice, usually does not. 2) Prohibition is not explicit in HKFRS, but contained in criminal law, Companies Ordinance.

B. Audit

1. Auditing requirements

The Companies Ordinance[35] requires companies incorporated in Hong Kong, China to have their annual financial statements audited. Financial statements must be approved by the company board of directors and signed on its behalf by two directors or the sole director (additional officers in the case of a bank). The financial statements together with the auditor’s report must be sent to the company’s members. For public companies and companies limited by guarantee, copies of the financial statements and auditor’s report are required to be filed with the Companies Registry. Listed companies must send every member and holder of their securities a copy of their annual report including the annual accounts, together with a copy of the auditor’s report, within four months of the end of the financial year.[36]

The auditor's report must state the auditor's opinion as to whether:

- the financial statements have been properly prepared in compliance with the law;
- the statements give a true and fair view of the financial position and financial performance of the company.[37]

The auditor must state the following in the auditor's report if she/he is of the opinion that:

- the information in a directors' report is not consistent with the financial statements;
- adequate accounting records have not been kept by the company; or
- the financial statements are not in agreement with accounting records in any material respect.[38]

If the auditor fails to obtain all the information or explanations that are necessary and material for the purpose of the audit, the auditor must state that fact in the report. The auditor commits an offense and is liable to fines if she/he knowingly or recklessly causes a statement of such fact or the opinion that the financial statements are not in agreement with the accounting records in any material respect to be omitted from the report. Companies, their subsidiaries and accountable persons must provide the auditor all information, documents, and explanations required by the auditor – and any person who knowingly or recklessly makes a statement that is misleading, false or deceptive in a material particular to the auditor (orally or in writing) is guilty of an offense.[39]

The auditing standards applicable in the region (Hong Kong Standards on Auditing or HKSA) are fully converged with the ISA issued by IFAC/IAASB. The standards include all requirements of ISA 240 and 250. With respect to internal controls, the auditor considers them in connection with the entity's preparation of financial statements that give a true and fair view. Further, HKSA 315 (para.13) requires the auditor to "evaluate the design of those controls and determine whether they have been implemented, by performing procedures in addition to inquiry of the entity's personnel."[40]

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	The controls, in combination with the other components of corporate governance, appear sufficient in most respects.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	1) and 2): Per Companies Ordinance, all companies to have accounts audited annually. No special rules for SMEs. Audited financial statements with auditors' reports to be sent to shareholders, and to the Companies Registry in the case of a public or guarantee company.
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	Audits must follow accounting standards issued or specified by HKICPA, including HKSA, which are fully convergent with ISA including ISA 240 and 250.
Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks. 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	Per Companies Ordinance: 1) Auditor's report must state opinion on whether accounts are true and fair (SMEs excepted), and if accounts were properly prepared in accordance with laws and applicable standards. Auditor to evaluate internal controls by such means as testing. 2) Directors to sign financial reports. Banks: secretary or manager must also sign. Company officers and accountable persons must cooperate with auditor, and are liable for misleading statements to auditor.

2. *Auditor reporting of improprieties*

As mentioned, HKSA are fully converged with ISA including ISA 240 and 250. These provisions include a duty by the auditor to report and explain indications of fraud to management and to the board of directors or audit committee of the board.[41] Although auditors should be alert to evidence of fraud and illegality, and consider reporting these to external authorities, neither the audit standards nor other legal provisions require such reporting. However, under the Companies Ordinance (sec.410), in the absence of malice, an auditor of a company is not liable to any action for defamation in respect of any statement made by the auditor in the course of performing duties as auditor of the company. Also as noted previously, regulators such as HKMA, SFC, and HKEx expect regulated companies to report instances of fraud, corruption, and other illegalities – and these instances may come to light in reports to boards and managers by external auditors. Further, the SFO (sec.381) states that an auditor of a listed entity who communicates with the SFC in good faith will not incur civil liability.

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	Reporting of fraud or illegality required of auditor by HKSA/ISA 240, 250. Corruption not specifically mentioned.
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").	1) No explicit legal duty or HKSA requirement for auditor to report externally, though this is expected according to regulatory standards. 2) Companies Ordinance and SFO provide safe harbors.

C. Professional standards and independence

The accountancy profession, including the practice of financial reporting and auditing, is governed by HKICPA, a professional membership and standard-setting body. Basic requirements for auditor appointment, removal, and independence are provided in the Companies Ordinance (secs. 393 to 403, 416 to 419). Appointment is by the AGM, and removal is by ordinary resolution with notice (within 15 days) to the Companies Registrar – failure to give such notice makes the company and responsible officers liable for fines. An auditor being removed before the end of the appointment term may request the company to present to the members a cessation statement setting out the circumstances surrounding the proposed removal (sections 422 and 423). In addition, the auditor must submit a statement to the company of circumstances connected with the termination, if any, that should be brought to the attention of the company's members or creditors (section 425). The company must send a copy of the statement to the members (section 427).

HKICPA provides more detailed rules in the Code of Ethics,[42] which is fully converged with the IFAC/IESBA Code, and in the relevant Hong Kong Standard on Quality Control.[43] The Code addresses appointment, limits on non-audit work, auditor interests in the audited company, and companies' hiring of former auditors. Section 290 of the Code requires rotation of the key partner after seven years and a cooling-off period of two years. Threats related to long association of other partners must also be evaluated and, depending on the circumstance, rotation or regular independent quality reviews must be performed. The Code (secs.210, 220) and HKSQC no.1 (paras.28-35) discuss issues to be considered when professionals accept audit assignments, including recommended steps to remove or reduce conflicts of interest. The Code (sec.290) provides guidance aimed at ensuring that auditors do not fall into conflicts of interest due to actual or prospective non-assurance engagements (non-audit work), financial interests, employment or directorships with respect to the audited company.

The Professional Accountants Ordinance (PAO, secs.22-30) provides for the professional qualifications and registration of CPAs, and for licensing of individual practitioners and firms. The PAO (secs.32-42) also provides for monitoring and inspection of financial reporting and auditing performance, as well as professional discipline. The Ordinance (secs.1-10) establishes HKICPA as the professional governing body of accountants and auditors in Hong Kong, China, while the sections of the PAO on professional admission, quality control, and discipline set up the HKICPA organs responsible for those functions. HKICPA spells out the rules and procedures for each of these functions, as well as standards for continuing education on audit and ethics standards, by means of the Statements it issues in the Members Handbook.[44] Acknowledging that the HKICPA is a professional organization rather than a separate supervisory agency, the government is now preparing proposals to enhance the independence of the regulatory regime for auditors of listed entities, with a view to ensuring that the regime is benchmarked against international standards.

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) PAO spells out required qualifications, registration, certification standards. 2) HKICPA Code is fully converged with IFAC Code.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	Per PAO, and HKICPA Ethics Code and Quality Control Standards: 1) Appointment and removal processes defined, and the latter subject to notice to Registrar and auditor representations. 2) Non-assurance work should not overlap with audit engagement or affect objectivity, independence. 3) Code requires rotation of the key partner after seven years and a cooling-off period of two years, and earlier rotation if circumstances warrant. 4) and 5): Interests and employment should not overlap with audit engagement or affect objectivity, independence.
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) Requirements and standards spelled out in PAO. 2) Continuing training provided for in HKICPA Statement 1.500. 3) Quality supervision provided by HKICPA under Statements 1.400, 1.401. Government is framing proposals to strengthen independence of the accountancy regulatory supervisory regime. 4) HKICPA imposes discipline per PAO and Statement 1.101.

D. Enforcement

Hong Kong, China's legal, regulatory, and professional enforcement provisions in this area are comprehensive. Substantive legal-regulatory violations are governed by the Companies Ordinance, with the Securities and Futures Ordinance providing the additional disciplines for licensed corporations and the Insurance Companies Ordinance on insurance companies. Penalties under the SFO are fairly rigorous, including fines up to HKD 1 million (USD 129,000) and imprisonment for up to 7 years for manipulating accounting records or misleading the auditor appointed by the SFC for a licensed corporation with intent to defraud, etc. (sec.151, 162), and the same maximum penalties apply to a licensed corporation that fails to submit correct and timely audited accounts to the Securities and Futures Commission with intent to defraud, etc. (sec.156).[45] Regulation of companies is primarily the responsibility of the Hong Kong Stock Exchange and the Companies Registry. The Department of Justice is responsible for criminal proceedings, but has authorized the Companies Registrar to prosecute offenses under the Companies Ordinance.

Under the Professional Accountants Ordinance (sec.42), members of HKICPA who fail to comply with professional standards (accounting, auditing and ethical) may be liable to disciplinary action by HKICPA, whose jurisdiction covers its membership only. Under the PAO, the Council of the HKICPA may use its disciplinary processes to deal with complaints against CPAs including the enforcement of accounting and audit standard compliance. Sanctions include public censure, suspension or removal of membership, and monetary penalties. For every case to be heard, the PAO provides for a Disciplinary Committee to be convened by an independent lay person appointed by government, and to impose a range of sanctions. HKICPA is responsible for investigating auditing and reporting irregularities in relation to non-listed companies, while the Financial Reporting Council, an independent statutory body established under the Financial Reporting Council Ordinance, investigates auditing and reporting irregularities in relation to listed entities.

In response to questionnaires, Hong Kong, China provided data on penalties actually applied in recent years. For offenses under the Companies Ordinance relating to the keeping and preparation of accounting records, there were 35 cases, four prosecution summonses issued, and four convictions obtained in the period 2010-2013. The defendants were individuals, and each received a fine of HKD 2,000 (USD 258). During the same period, FRC – responsible for conducting enquiries on non-compliance with accounting requirements by listed companies – handled four enquiries against listed companies. One of them found no material non-compliance, and the remainder were corrected by the company or otherwise resolved.

As for non-compliance with professional standards (accounting and auditing) by members of HKICPA, during the 2010-12 period, there were 5 investigations by HKICPA and 15 by the Financial Reporting Council (under its Ordinance, FRCO). During the same period, Disciplinary Committees considered 44 cases and issued 26 disciplinary orders. (Disciplinary orders were issued subsequently for the remaining 18 cases). The FRC cases involved 15 companies, along with two individuals who were brought in as co-defendants. The cases completed by the Disciplinary Committees against members of HKICPA involved 23 cases where only individuals were involved, and three that involved individuals and professional firms. Penalties imposed by the Disciplinary Committees during the period included fines ranging from HKD 10,000 to HKD 550,000 (USD 1,300 to USD 71,000), cancellation of practice certificates for two to three years, and removal from HKICPA membership (and the profession) for three months up to permanent removal (i.e. loss of membership).

International standard	Compliance by member country
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2): Accounting and audit rules and procedures appear fairly rigorous. Whether they fully used to combat corruption involving companies is not clear.
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Sanctions include fines up to amounts in excess of USD 100,000 per infraction and imprisonment for up to 7 years for the most serious violations – e.g. fraudulent manipulation of accounts. 2) Penalties apply to individuals, companies, and often both. 3) Enforcement mechanisms include criminal courts, regulators, and HKICPA Disciplinary Committees.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) through 3): See above.

5. Conclusion and recommendations

A. General efforts to prevent corruption involving the private sector

Hong Kong, China has a wealth of ongoing activities to support corruption prevention generally and in the private sector in particular. ICAC has led the way with awareness-raising, training, advisory services, liaison with companies, an SME network, and a corruption hotline. Some of this activity has, with ICAC's assistance, been absorbed into sector-specific programs run by associations, as in the financial and insurance industries. Sentence-mitigation is reported to be available to encourage offenders to self-report. Private sector integrity pacts are not especially in evidence, although government does require contractors to abide by integrity clauses. Government notes that HKICPA has been organizing the HKICPA Best Corporate Governance Disclosure Awards since 2000 and FSTB has been one of the supporting organizations of the Awards. This is a worthy initiative that incorporates similar incentives to an integrity pact.

Recommendation

1) Continue supporting private sector-led standard-setting and ethics initiatives. Enabling civic and business anti-corruption centers of research, standards development, and policy initiative would be an important contribution to the future. Incorporate integrity pacts into the mix in such areas as government procurement and foreign investment.

B. Internal controls

The elements of internal control in Hong Kong, China are dealt with through a combination of legislation and standards issued by regulators. The latter are non-statutory, but in effect enforceable because they express the regulators' view of how supervised entities should be structured and managed. The ultimate sanction is the withholding of regulatory approvals, disciplinary sanctions include fine, reprimand, prohibition, suspension and revocation of license, or the tightening of requirements. Some of the internal control provisions are quite comprehensive, such as those dealing with corporate culture (HKMA), gifts, agents, and risk-management (SFC).

Recommendations

1) Consider mandating by law key provisions on internal audit, audit committee, and internal controls. Companies within an effective regulator- or SRO-led voluntary standards regime could be considered as compliant, but the legal provisions would also oblige other firms and sectors to adopt good practice. The voluntary regimes could also be made subject to a legal standard of compliance (e.g. percentage of entities compliant with each standard) as a condition for their continuation.
2) Strengthen the role of internal audit and the audit committee (and external audit as well) in enforcing safeguards against corruption risk. Also bring more explicit corruption-prevention standards and procedures within the oversight of audit and internal control. In particular, require the audit committee to provide guidance to staff on preventing corruption, and to respond immediately to evidence of corruption. Audit committee independence criteria could be made more stringent and subject to challenge, in light of the many family-run companies and conglomerates listing in Hong Kong, China.

C. Integrity of financial statements

Standards for financial reporting, auditing, and professional qualification and conduct appear quite comprehensive and compliant with international best practice. Reporting and audit standards are converged with IFRS and ISA, and all companies are subject to annual independent audit. HKICPA members are obliged to comply with professional standards and compliance is enforced. Standards of professional conduct are largely voluntary rather than legislated, with the oversight body – in this case HKICPA – enforcing them by way of licensing. Penalties for violation of financial reporting, corporate governance, and professional standards are potentially heavy.

Recommendations

1) In addition to rigorous penalties for manipulation of accounts, add explicit prohibitions of off-the-books transactions and similar tactics that may be used to hide corruption. These could be framed so that liability is strict rather than dependent on a showing of intent.
2) Consider imposing an explicit duty for the external auditor to report compelling evidence of fraud or corruption to external authorities.
3) Review enforcement of technical and professional standards. Consider placing HKICPA's oversight and discipline functions in a state agency, or alternatively bringing them under closer government supervision. Fine amounts could be adjusted upward, especially for senior officers and for companies themselves.

Hong Kong, China Laws, Regulations, Policy Documents Referenced:

Banking Ordinance (Cap. 155, Laws of Hong Kong), http://www.legislation.gov.hk/blis_pdf.nsf/CurAllEngDoc/5A827AA51F496D08482575EE004568BC/$FILE/CAP_155_e_b5.pdf

Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission, http://en-rules.sfc.hk/en/display/display.html?rbid=3527&element_id=1868.

Companies Ordinance (Cap.622, Laws of Hong Kong), http://www.legislation.gov.hk/blis_pdf.nsf/6799165D2FEE3FA94825755E0033E532/707C1C4DC6BDF92848257A5500549A21/$FILE/CAP_622_e_b5.pdf.

Financial Reporting Council Ordinance (Cap. 588, Laws of Hong Kong).

Hong Kong Exchanges and Clearing Limited, *Listing Rules* (and Corporate Governance Code), http://www.hkex.com.hk/eng/rulesreg/listrules/mbrules/Documents/consol_mb.pdf.

Hong Kong Institute of Certified Public Accountants, *Code of Ethics for Professional Accountants*, http://app1.hkicpa.org.hk/ebook/HKSA_Members_Handbook_Master/volumeI/COErevised.pdf.

HKICPA, *Hong Kong Standard on Quality Control* No.1, http://www.hkicpa.org.hk/file/media/section6_standards/quality_assurance/hksqc1.pdf.

Independent Commission Against Corruption Ordinance (Cap. 204, Laws of Hong Kong), http://www.legislation.gov.hk/blis_pdf.nsf/6799165D2FEE3FA94825755E0033E532/A3E9ED78744D8631482575EE004CB37D/$FILE/CAP_204_e_b5.pdf.

Insurance Authority, *Guidance Note on the Corporate Governance of Authorized Insurers*, http://www.oci.gov.hk/download/gn10-eng.pdf.

Prevention of Bribery Ordinance (Cap. 201, Laws of Hong Kong), http://www.legislation.gov.hk/blis_pdf.nsf/CurAllEngDoc/660A25EA15B8C9D6482575EE004C5BF1/$FILE/CAP_201_e_b5.pdf.

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Securities and Futures Commission, *Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission*, http://en-rules.sfc.hk/en/display/display.html?rbid=3527&element_id=162.

Securities and Futures Ordinance (Cap. 571, Laws of Hong Kong), sec.169, http://www.legislation.gov.hk/blis_ind.nsf/WebView?OpenAgent&vwpg=CurAllEngDoc*496*100*568.1#568.1.

SPM CG-1: Corporate Governance of Locally Incorporated Authorized Institutions, http://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/supervisory-policy-manual/CG-1.pdf.

SPM CG-3: Code of Conduct, http://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/supervisory-policy-manual/CG-3.pdf.

SPM CG-6: Competence and Ethical Behaviour, http://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/supervisory-policy-manual/CG-6.pdf.

SPM IC-2. *Internal Audit Function*, http://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/supervisory-policy-manual/IC-2.pdf.

NOTES

1 Officially, the Hong Kong Special Administrative Region (SAR).

2 http://www.bbc.co.uk/news/world-asia-pacific-16517764; http://www.dfat.gov.au/geo/hong_kong/hong_kong_brief.html

3 Martin Yip, “Can Hong Kong stay corruption-free under China?” 10 July 2013, BBC Chinese, Hong Kong, http://www.bbc.co.uk/news/world-asia-china-23223457.

4 https://www.cia.gov/library/publications/the-world-factbook/geos/hk.html; http://www.dfat.gov.au/geo/hong_kong/hong_kong_brief.html.

5 This and later sections draw substantially on questionnaire responses by ICAC and the Hong Kong Institute of Certified Public Accountants – although the author has done separate research to check and supplement this material and is responsible for the content.

6 Independent Commission Against Corruption Ordinance (Cap. 204, Laws of Hong Kong), http://www.legislation.gov.hk/blis_pdf.nsf/6799165D2FEE3FA94825755E0033E532/A3E9ED78744D8631482575EE004CB37D/$FILE/CAP_204_e_b5.pdf.

7 http://www.eaa.org.hk/CPDScheme/IntegrityManagementProgramme/tabid/676/language/en-US/Default.aspx.

8 http://www.eaa.org.hk/Compliance/Codeofethics/tabid/100/language/en-US/Default.aspx; http://www.eaa.org.hk/Compliance/Practicecirculars/tabid/101/language/en-US/Default.aspx; http://www.eaa.org.hk/Portals/0/Sections/CC/BPC.pdf.

9 Government comments.

10 The sources of all standards are provided in footnotes to the tables presented in the section of the Review entitled *International Standards for Country Reports.*

11 SPM IC-2. *Internal Audit Function*, http://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/supervisory-policy-manual/IC-2.pdf.

12 Government comments.

[13] BDO (2013) Corporate Governance review 2013, p.22, http://www.bdo.com.hk/web/en/publications/Research/CorporateGovernanceReview.
[14] http://www.theiiahk.org/.
[15] http://www.hkex.com.hk/eng/rulesreg/listrules/mbrules/Documents/consol_mb.pdf. The Code is Appendix 14 of the Rules.
[16] A major area of non-compliance was reported to be the requirement of a whistleblower policy, Enoch Yiu, "Hong Kong companies failing to protect rights of small investors," *South China Morning Post*, 04 February, 2014, http://www.scmp.com/business/money/markets-investing/article/1420508/poor-corporate-governance-may-make-foreign.
[17] See SPM IC-2. *Internal Audit Function*, para.2.5. Also, OCI has required insurance companies to establish audit committees to review financial reporting and internal control systems of insurance companies; government comments.
[18] Cap. 622, Laws of Hong Kong, Part 11 (sec.383, 465, 484 to 546), dated March 3, 2014.
[19] Banking Ordinance (Cap. 155, Laws of Hong Kong), Sched. 7, paras.10, 12, http://www.legislation.gov.hk/blis_pdf.nsf/CurAllEngDoc/5A827AA51F496D08482575EE004568BC/$FILE/CAP_155_e_b5.pdf.
[20] SPM CG-1: *Corporate Governance of Locally Incorporated Authorized Institutions*, http://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/supervisory-policy-manual/CG-1.pdf.
[21] SPM CG-3: *Code of Conduct*, http://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/supervisory-policy-manual/CG-3.pdf.
[22] SPM CG-6: *Competence and Ethical Behaviour*, http://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/supervisory-policy-manual/CG-6.pdf.
[23] Securities and Futures Ordinance (Cap. 571, Laws of Hong Kong), sec.169, http://www.legislation.gov.hk/blis_ind.nsf/WebView?OpenAgent&vwpg=CurAllEngDoc*496*100*568.1#568.1.
[24] Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission, http://en-rules.sfc.hk/en/display/display.html?rbid=3527&element_id=1868.
[25] Prevention of Bribery Ordinance (Cap. 201, Laws of Hong Kong), http://www.legislation.gov.hk/blis_pdf.nsf/CurAllEngDoc/660A25EA15B8C9D6482575EE004C5BF1/$FILE/CAP_201_e_b5.pdf.
[26] http://en-rules.sfc.hk/en/display/display.html?rbid=3527&element_id=162.
[27] http://www.oci.gov.hk/download/gn10-eng.pdf.
[28] Section 73 of Crimes Ordinance (Cap. 200); government comments.
[29] Companies Ordinance, sections 359 to 367, section 379 to 381, Schedule 3.
[30] Professional Accountants Ordinance (Cap. 50, Laws of Hong Kong), sec.18A, http://www.legislation.gov.hk/blis_pdf.nsf/6799165D2FEE3FA94825755E0033E532/94DF79148C72427F482575EE003367EB/$FILE/CAP_50_e_b5.pdf.
[31] http://www.ifrs.org/Use-around-the-world/Documents/Jurisdiction-profiles/Hong-Kong-IFRS-Profile.pdf.
[32] http://app1.hkicpa.org.hk/ebook/HKSA_Members_Handbook_Master/volumeII/hkas37.pdf.
[33] Government comments.

[34] The HKEx Listing Rules, Appendix 16, address financial reporting for listed companies.
[35] Companies Ordinance, sections 387, 405, 429. 664 and Schedule 6.
[36] HKEx Listing Rule 13.46(1).
[37] This includes subsidiaries, where consolidation is required. As noted above, the “true and fair” requirement does not apply to companies that prepare simplified accounts.
[38] An auditor is required to include the three negative statements only if he/she encounters such issues (section 407(2), Companies Ordinance).
[39] Companies Ordinance, secs. 412, 413.
[40] Government comments.
[41] HKSA 240.40-43, http://app1.hkicpa.org.hk/hksaebk/HKSA_Members_Handbook_Master/volumeIII/hksa240cfd.pdf.
[42] http://app1.hkicpa.org.hk/ebook/HKSA_Members_Handbook_Master/volumeI/COErevised.pdf.
[43] http://www.hkicpa.org.hk/file/media/section6_standards/quality_assurance/hksqc1.pdf.
[44] Statement 1.500 on Continuing Professional Development, http://app1.hkicpa.org.hk/ebook/HKSA_Members_Handbook_Master/volumeI/1_500.pdf; Statements 1.400 and 1.401 on Practice Review, http://app1.hkicpa.org.hk/ebook/HKSA_Members_Handbook_Master/volumeI/1_400.pdf, http://app1.hkicpa.org.hk/ebook/HKSA_Members_Handbook_Master/volumeI/1_401.pdf; Statement 1.101 on Disciplinary Committee Proceedings Rules, http://app1.hkicpa.org.hk/ebook/HKSA_Members_Handbook_Master/volumeI/1_101.pdf.
[45] The Ordinance does not clarify how the penalties affect a company. As elsewhere, fines appear to attach to the company and directors, but prison terms only to the latter according to criminal law standards.

Indonesia

1. Introduction

Indonesia has experienced several successes and setbacks in its transition to democracy and transparency beginning in 1998. Important advances have been made in the fight against corruption, though bribery, fraud, and embezzlement continue to pose serious problems. An Ernst & Young survey in 2012 revealed that 72% of surveyed executives perceived bribery and corruption to be widespread in the Indonesian business environment. At a rate of 76%, respondents admitted that they were willing to make cash payments or give personal gifts to gain or retain business, or misstate the company's financial performance in order to survive an economic downturn. Illicit payments are reported frequently to be made in such areas as imports and exports, public utilities, annual tax payments, and awarding of public contracts and licenses. The Indonesian business community gains near-term competitive advantage when government officials favor well-connected companies and individuals, as often happens, in deciding upon policies and contracts. It is also reported that many tenders, especially at the regional level, are manipulated by companies bribing competitors to withdraw their bids.[1]

At the same time, accountability and anti-corruption sentiment continue to strengthen. Since its founding in 2002, the Corruption Eradication Commission (KPK) has gained strength and credibility.[2] Media exposure of the arrests of high-ranking state officials and politicians, and the prison terms they have received, have help shift the attitudes of Indonesians toward less tolerance of corruption, according to an annual survey by the Central Statistics Agency.[3] High-profile prosecutions of businessmen also play a role. For example, a top executive of Kernel Oil, a Singapore company, was recently convicted of attempted bribery in seeking to gain a position for the company in Indonesia's oil-and-gas industry. The executive was sentenced by the Jakarta Anti-Corruption Court to serve three years in prison and pay a fine of IDR 200 million (USD 16,400).[4]

The influence of social networks, especially those based on extended family, continues to play an important role in business as well as in politics. A World Bank analysis of the corporate sector estimates that the three largest shareholders control an average of 60.9 percent of listed companies, although ownership is not transparent and information can be difficult to obtain. The majority of listed companies are controlled by families, with ten or so large family-owned company groups playing the predominant role. The national government controls some 114 companies (mainly non-listed) through the Ministry of State Owned Enterprises.[5] These influences pose a challenge to transparent corporate governance and the prevention of corruption in the private sector.

2. General efforts to prevent corruption involving the private sector

In Indonesia, anti-corruption has featured prominently on the reform agenda, as reflected in the adoption of the Law on Corruption Eradication (No.31/1999) and especially in the establishment of the Corruption Eradication Commission (KPK) by Law No. 30/2002. Corruption was understood to be an obstacle to attracting foreign investment and to building good external relations. Ratification of UNCAC in 2006 and the strengthening of KPK showed the government's seriousness. The National Committee on Governance, established by the Coordinating Economic Ministry and 30 representatives from the public and private sectors, issued a Code of Good Corporate Governance (CGCG), most recently updated in 2006 (World Bank 2010: 9). Presidential Instruction No. 17/2011 on corruption prevention and eradication outlined 13 programs and 106 action plans in these areas. In March of 2012, the government issued the National Strategy on Corruption Prevention and Eradication, which was developed over four years with input from civil society.[6] One key objective is to improve governance and transparency in the private sector over both the medium (2012-2014) and long term (2012-2025). The strategy also aims to develop codes of ethics including anti-corruption principles for attorneys, public accountants, and tax consultants. In addition, KPK has initiatives on whistle-blowing and "gratuity control" with government ministries and SOEs, and holds an annual national conference.[7]

Efforts from the private sector side are also advancing. Indonesia Business Links (IBL) is a non-profit foundation established in the wake of the Asian Financial Crisis. The organization works to establish ethical business practices and corporate social responsibility. IBL has a Business Ethics Initiative, in which it collaborates with KPK to provide information, training, and standard-setting on ethical business practices. Its activities in recent years include:

- Ethics workshops with Pertamina (state oil company) and its suppliers and vendors in nine cities,
- Publishing an SME code of conduct, and
- Creating a business anti-corruption integrity pact jointly with the Indonesia Chamber of Commerce.[8]

Anti-corruption campaigns and workshops are also conducted by business associations (KADIN and APINDO) dedicated to this theme.

International standard[9]	Compliance by member country
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	Initiatives underway from both public and private sector sides.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) KPK encourages SOEs to implement a whistle blower system to report misconduct in the company. 2) No provision.
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) The 2011 Presidential Decree announced several relevant initiatives. KPK and IBL cooperate on corruption prevention programs in the private sector. IBL held ethics workshops for oil industry firms. 2) IBL collaborates with KPK on awareness-raising and workshops on prevention of private sector corruption. Other business community initiatives. 3) National Committee on Governance issued a Code of Good Corporate Governance, updated in 2006. IBL published an SME code of conduct.
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	IBL sponsors a private sector integrity pact with the Indonesia Chamber of Commerce. KPK promotes good governance in some SOEs through a gratuity control program.

3. Internal controls

A. Internal audit

Internal audit is required for public companies, i.e. those having at least 300 shareholders and paid-in capital of at least IDR 3 billion (about USD 250,000).[10] Internal auditing standards are provided in Government Regulation

No. 60 of 2008 on the internal control governance system. Internal audits use Public Accountants Professional Standards (SPAP, see below), which are based on International Standards of Auditing (ISA). Regulation No. 60 also refers to the COSO control framework including environment and activity control, risk assessment, information and communication, and monitoring.

Procedures are defined in Audit Board of the Republic of Indonesia (BPK RI) Regulation No. 1 of 2007 on financial examination standards. This regulation also provides that the internal auditor should report directly to the board of directors or an equivalent body. Private firms are not required to have internal audit.

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	Per securities regulator (Bapepam/OJK), public companies are required to establish an internal audit function. The effectiveness of this for corruption control is not fully clear.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect "illegal acts" in the books and records of companies, including bribery and other forms of corruption.	1) Per Bapepam rule, all internal auditors must comply with IIA profesional standards. 2) There appears to be no organized internal audit profession with governing body and standards.
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	1) Public companies must have internal audit. Standards and procedures defined in regulations citing COSO norms. These not required of non-listed firms. 2) and 3): No provisions. 4) Regulation requires direct reporting to board (or equivalent).

B. Audit committee

Indonesian companies have a two-tier board structure: a board of commissioners (BOC) and a board of directors (BOD). The BOC is designed to oversee and advise the BOD, which in turn carries out the day-to-day operations of the company. In the past, the BOC in many companies played a limited role, at best, with almost all power vested in the BOD (and controlling shareholders), but regulatory changes in recent years have prompted many BOCs to become more active in overseeing their companies(World Bank 2010: 20). All limited liability companies must establish both BOD and BOC, although the latter may have only one member unless the company raises public capital or deposits (Company Law of 2007, art.108).

Public companies must have an independent audit committee with an independent BOC commissioner as chair. The Financial Services Authority (OJK) and the Stock Exchange (IDX) have adopted regulations providing for the audit committee's charter, responsibilities, reporting requirements, and independence criteria. The audit committee monitors internal audits, ensures the accuracy of financial reports, and advises the BOC on a wide range of corporate governance concerns. [11] The committee is supposed to act independently and include commissioners of the BOC and member(s) with financial expertise. [12] Private companies are not required to have audit committees.

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	Per OJK and IDX regulations: 1) Audit committees required for public companies. 2) Committee to include independent BOC members and two members from outside the public company.
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers, employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	1) Committee oversees accounting and audit. 2) through 5): No provisions.

C. Internal control and compliance systems

Indonesia's capital market and tax regulations provide voluntary standards for internal control and compliance for listed companies, as does the Corporate Governance Code (CGCG) for all public companies. These standards include guidelines for establishing corporate codes of conduct, with monitoring of compliance to be handled by internal auditors and/or audit committees and included in the internal charters for these functions. The BOD is responsible for internal control and risk management, while the BOC oversees the implementation of these responsibilities (World Bank 2010: 22). Public companies should disclose their activities in these and other areas of corporate governance in their annual reports. Publicly-owned financial institutions are reported to be implementing risk-based approaches here, consistent with Bank Indonesia's prudential requirements and its 2006 corporate governance regulation, applicable to listed and non-listed banks (World Bank 2010:10). Private companies are not required or pressured to establish or report on internal controls.

In practice, corporate governance appears to be improving but the implementation of internal control systems across public companies is uneven. According to the World Bank, the CGCG has indirectly served as an important source of good practice, especially as regulatory authorities have adopted key provisions and made them mandatory. This approach increases compliance with specific provisions, which reduces flexibility for small companies in those areas while leaving most of the CGCG's provisions as voluntary norms (World Bank 2010: 10). Numerical ratings suggest that banks and state-owned enterprises perform significantly better in corporate governance than non-banks and private sector companies. Banks and SOEs are closely supervised by the Central Bank and the Ministry of SOEs, in addition to OJK, and this strengthens corporate governance practice as a result. Despite this improvement, companies in general do not follow international standards with regard to selection of suppliers, whistle-blower protections, or anti-corruption policies. Since the CGCG is voluntary, most companies do not disclose their level of compliance with it in their annual reports.[13] While government has worked to strengthen integrity in state administration, it has not yet placed high priority on internal controls, codes of conduct, or compliance in the corporate sector.[14]

International standard	Compliance by member country
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees. 4) Risk-based approach: • Individualized assessment of risks to the enterprise, including corruption risks. • Regular monitoring and re-assessment of corruption risks.	1) Internal corporate governance standards and controls are largely voluntary and do not apply to private companies. Listed companies, SOEs, and banks are expected to implement CGCG. 2) Internal auditor or audit committee intended to monitor compliance with voluntary standards on behalf of BOD. Testing of systems not specified. 3) No requirement. 4) Banks take risk-based approach and perform better than other companies on corporate governance metrics.
Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements. 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations. 4) Require for third-party representatives, consultants, or	1) CGCG emphasizes compliance with laws. 2) CGCG calls for prohibition and prevention of corruption. 3) CGCG provides guidance on gifts, etc. KPK encourages some SOEs and IBL to implement gratification control programs. 4) No requirement. CGCG is voluntary, and company performance is not consistent with the international standards

agents: • Written contract, adherence to company ethics standards and anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	
Enforcement, including sanctions for failure to comply.	No enforcement provisions.

4. Integrity of financial statements

A. Accounting

1. Financial records

Indonesian laws on corporate documents (Law No 8/1997) and tax administration (Law No.16/2009) provide standards on bookkeeping and retention of financial records. Law No.8/1997 (art.5) defines accounting documents to include annual balance sheets, profit and loss statements, daily transaction journals, and other materials dealing with a company's business activities. These documents, along with supporting data, are to be kept for ten years (art.11). The tax law penalizes the keeping of false books and the submission of documents not based on actual transactions, requiring that the records reflect the actual condition of the company.[15] The Penal Code (art.263) fixes prison terms as punishment for intentional falsification of documents and intentional use of such documents.[16]

International standard	Compliance by member country
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	Companies required to keep books and supporting data for ten years, per Law no.8/1997.
Prohibitions (UNCAC 12(3), OECD Convention 8(1), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	1) Income Tax Law and OJK regulations penalize use of false records; Penal Code punishes intentional falsification. 2) Destruction within retention period prohibited as above. 3) and 4): No explicit prohibition. 5) and 6): Income Tax Law penalizes use of tax documents not based on actual transaction.

2. Financial reporting requirements

The Financial Accounting Standard Board (DSAK), part of the Indonesian Institute of Accountants (IAI) sets accounting standards. IAI has updated local standards to reduce the gap with current IFRS. IAI announced its intention to converge to full IFRS in January 2012, though previous convergence efforts have missed similar deadlines (World Bank 2010: 19). Indonesia's announced policy is to maintain its national accounting standards (PSAK) and converge them gradually with current IFRS. As of January 2012, PSAK were based on the 2009 IFRS with some modifications, and these standards continue to be updated to current IFRS.[17] These updated PSAK apply to all companies listed on IDX, and will gradually be applied to other entities. Also, IAI houses the Indonesia Sharia Accounting Standards Board, which sets standards for businesses organized according to Islamic financial principles.[18]

The World Bank reported in 2011 that there had been a significant increase in PSAK that are IFRS-convergent. Financial Accounting standards for private companies were issued in 2009 based on IFRS for SMEs. The micro, small and medium-sized enterprise sector in Indonesia accounts for over 50% of GDP. The IAI body charged with issuing standards, DSAK, reportedly faces significant resource constraints in achieving convergence of local accounting standards with IFRS (World Bank 2011:i, 6, 18).

All listed companies are required to produce annual reports with audited financial statements. The Capital Market Law (No.8/1995, art. 86(1)) requires issuers and listed companies to publish annual and other periodic reports, and submit them to OJK. Even though not required to do so, some companies publish downloadable financial statements and annual reports, as well as reports on business operations, on their company websites. Audited financial statements should be published within 90 days after the close of the financial year. Consolidation of financial statements is required if a public company controls or has majority ownership in other companies. Off-balance sheet items are said to be restricted under PSAK 50 and 55, though there appears to be no equivalent to IFRS 10. OJK regularly monitors and enforces compliance with basic disclosure requirements.[19]

Disclosure must also cover financial performance indicators, related-party transactions, and other matters. Disclosure of material contingent liabilities is required by PSAK 57, which is fully consistent with IAS 37. Listed companies are required under the Capital Market Law to inform the financial market regulator of any material decision, information or facts that could influence stock prices or investment decisions, such as business combinations, conflicts of interest, and the replacement of auditors.[20]

International standard	Compliance by member country
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) Listed companies must use PSAK, based on an older version of IFRS now being updated for full convergence. 2) Accounting standards for non-public companies issued in 2009 based on IFRS for SMEs. 3) Consolidated reporting required for majority-owned affiliates. Off-balance sheet items said to be limited.
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) PSAK 57 is fully consistent with IAS 37, which would normally not require disclosure. Capital Market Law requires disclosure of material events such as conflict of interest. 2) No explicit prohibition.

B. Audit

1. Auditing requirements

External audit in the private sector is governed by the Public Accountants Professional Standards (SPAP) issued in 2011 by the Indonesian Institute of Certified Public Accountants (IAPI) – as authorized in a 2008 decree of the Ministry of Finance. Existing Indonesian audit standards are based on those issued by the US AICPA. In 2005, IAPI decided to implement International Standards on Auditing (ISA) effective in 2007, and the translation got underway, but adoption was delayed to 2013 (World Bank 2011:17-23; World Bank 2010: 19). Indonesia is still in the process of fully adopting the ISA.[21]

External audits of financial statements are required for public companies, SOEs, banks and other entities with financial liabilities to the public, and firms whose assets or annual business turnover exceed IDR 50 billion (USD 4.1 million). All listed companies and financial institutions must be audited by a CPA. Public accountants must be registered with OJK in order to provide professional services to the capital market or to audit the annual financial statements of banks. Audited financial statements are to be attached to a company's annual report, and regulators in some sectors require newspaper announcements. Banks are required to submit semi-annual and annual audited financial statements to Bank Indonesia (BI) as well as to the consumer protection regulator, rating agencies, and two finance magazines. Securities regulations require public companies to have their BOC and BOD sign the annual report (including the financial statements) as confirmation of their responsibility for it, and to have the annual report itself audited by a CPA.[22]

Capacity constraints are reported to affect the quality of audits. Compliance with applicable auditing standards differs among audit firms of different sizes. The small and medium-sized accounting firms, due to lack of resources for audit quality control, face challenges in providing appropriate auditing services to financial institutions and other entities with complex business transactions. This potentially has serious implications for the ISA convergence and for the quality of financial information available to market participants in Indonesia (World Bank 2011: 13, 23).

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	Unclear based on delayed rollout of ISAs and shortage of audit firm capacity, though the situation is reported to be improving.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	1) Independent audits required for public companies, SOEs, banks and other firms meeting size threshold. 2) No specific SME standards.
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	Implementation of ISA was planned for 2013, and translation was underway.
Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks. 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	1) Auditors are required to certify financial statements, provide opinion on preparation, and describe procedures. 2) BOD and BOC must sign the financial statement and confirm their responsibility for it. Annual reports to be audited. Deliberate falsification subject to prison term.

2. *Auditor reporting of improprieties*

SPAP standards governing audit include (or will soon include) ISA 240 and 250. It is reported that, for public companies, Bapepam/OJK regulations require "whistleblowing" by auditors on certain matters, including transactions where there has been a conflict of interest and there has been no shareholder approval. External reporting of fraud or other irregularities by the auditor is not required or permitted except in the case of reporting to a new auditor taking over responsibility, or to shareholders and debtors, or where there is an express legal requirement or court order.[23] Thus, internal reporting to the BOD/BOC will be required once the ISA have been adopted, but reporting to external authorities is allowed only in limited circumstances.

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	Internal reporting appears to be required, and in any case will be required when ISA are fully adopted.
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").	1) ISA 240 and 250 permit external reporting where legal duties exist. SPAP confirm this, otherwise restricting such reporting to specific situations. 2) No safe harbor.

C. Professional standards and independence

The Indonesian Institute of Accountants (IAI) is the professional body of accountants and a member of the International Federation of Accountants (IFAC). IAI issues accounting standards, formulates and enforces the professional code of ethics, accredits public accountants, and disseminates information and training. The IAI Code of Conduct states the ethical principles, rules, and interpretations governing the accounting profession. Membership in IAI is not mandatory for preparers of financial statements or for auditors (World Bank 2011: i, 11).

The equivalent body for auditing professionals is IAPI, which was until recent years part of the IAI governing structure. IAPI develops and disseminates audit standards (SPAP) as well as the Public Accountants Code of Professional Ethics applicable to external auditors. The Code (issued in 2008, effective 2010), is based on the IFAC Code of Ethics. OJK imposes independence requirements for the auditor and audit firm, limits non-audit services that can be provided, and fixes maximum rotations for audit firms (six years) and partners (three years). BI requires a five-year rotation for both firms and audit partners providing external audits to banks. Each of these standards exceeds the IFAC Code, which requires audit partner rotation after seven years. The separation of IAPI from IAI led to some transition problems for IAPI in particular (World Bank 2010: 19; World Bank 2011: 10-12).

The Ministry of Finance hosts the Center for Supervision of Accountants and Appraiser Services (PPAJP), which provides broad oversight of the accounting and auditing profession. The Center licenses both audit firms and auditors, who must also be certified by the IAPI. Auditors of listed companies must be registered with the financial market regulator OJK, and auditors of banks must be registered with BI. PPAJP had carried out on-site reviews of about 50 accounting firms by 2010. OJK is also in the early stages of creating a more effective audit inspection capability. IAPI has internal procedures to review the quality of its members' work and can sanction its members. The Indonesia Stock Exchange (IDX) also reviews financial statements of listed companies (World Bank 2011: 18, World Bank 2010: 19).

Some gaps exist in this framework. PPAJP reportedly has insufficient resources to police a large accounting and audit profession, although it has become more active in enforcement. The rules on selection and removal of external auditors are not spelled out in the Company Law. The CGCG recommends that shareholders choose based on the recommendation of the BOC and Audit Committee, and this is reported to be the practice in most companies. While audit standards give the auditor the responsibility to ensure that statements are free from material misstatement, auditors have no explicit liability to the company, shareholders, or other investors. No accounting firm has been sued for substandard work by companies, shareholders, or third parties (World Bank 2010: 19). In addition, most listed companies reportedly do not disclose the audit and non-audit fees of their audit firms (ADB 2013: 11-19).

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) IAI sets standards for accountants, certifies and disciplines. 2) Code of ethics based on IFAC.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	1) Appointment and removal standards not detailed in Company Law. Auditors of listed companies must be registered with OJK, and CGCG advises appointment on recommendation of BOC and Audit Committee. 2) Non-audit fees for company auditors not consistently disclosed. 3) Rotation rules for audit firms and partners exceed IFAC. 4) and 5): No restrictions.
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) IAPI and PPAJP jointly license auditors and audit firms, while listed firm and bank auditors require additional registration with regulators. 2) IAPI provides continuing education for CPAs, who have a responsibility to update their skills through training. 3) and 4): Professional body (IAPI) and separate state body (PPAJP) supervise audits and discipline professionals, though both have capacity issues.

D. Enforcement

The Corporate Finance Bureau of OJK performs field examinations and desk reviews on a sample basis to determine companies' compliance with accounting standards and disclosure requirements. Infractions detected through these reviews may trigger administrative sanctions including written admonitions, restriction or suspension of business activities, revocation of business licenses or approvals, fines, and in some cases imprisonment. For example, fines ranging from IDR 1 million to IDR 500 million (USD 80 to USD

41,000) can be imposed for late submission of financial statements. Anyone who loses, destroys, alters, or falsifies records of a registered issuer or a listed company with the intent to mislead OJK or defraud another person is subject to imprisonment of up to of three years and a maximum fine of IDR 5 billion (USD 410,000)(World Bank 2011: 18).The Income Tax Law penalizes the use of false books and of records not based on actual transactions with imprisonment for up to six years and fines up to six times the amount of tax underpayment. In addition, under the Penal Code (art.263), falsifying documents that may harm people relying on them, or deliberately using such documents in a way that may cause harm, is subject to a maximum penalty of six years' imprisonment.[24]

These sanctions have been used to some extent in practice. For example, in the period 2005-2009, the securities regulator (then BAPPEPAM-LK) imposed fines for violations of such rules as the following (World Bank 2010: 12):

- BOD responsibility for financial statements: IDR 14 billion (USD 690,000)
- Filing of annual reports: IDR 16.3 billion (USD 803,000)
- Guidelines preparation of financial statements: IDR 1.4 billion (USD 72,000).

These aggregate numbers suggest that penalties are not set or imposed at a level that creates deterrence. Further, OJK is reported rarely to refer cases for prosecution.

Civil remedies are available as well, in principle. Company law allows shareholders to file a direct suit against the company. Shareholders with at least 10 percent of the voting rights may also file a derivative suit on behalf of the company against directors or commissioners who by their fault or negligence create losses for the company. These same shareholders may request a court to order an inspection of the company if it is believed the company or a member of either board "committed an illegal action which may cause adverse effect to the shareholders or a third party." Under the capital market law, any person who suffers losses due to violation of the law may sue for compensation. It is reported, however, that few of these legal actions are carried out in practice, due perhaps to passive minority shareholders, legal costs, or judges' lack of experience in capital market matters (World Bank 2010: 17).

International standard	Compliance by member country
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2): Unclear. Fines may not be at deterrent levels for companies, and enforcement has not been fully effective.
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Administrative fines for financial reporting infractions, criminal fines and imprisonment for falsification, civil remedies for resulting harm to investors. 2) Penalties apply to companies as well as individuals. 3) Effectiveness of enforcement is unclear, though administrative, criminal, and civil sanctions are available.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) through 3): See above.

5. Conclusion and recommendations

A. General efforts to prevent corruption involving the private sector

Indonesia enjoys an impressive level of anti-corruption awareness and activity, a legacy of the crisis-era regime change and the democratic aspirations associated with it. This includes a number of significant initiatives on prevention of corruption in the private sector from government, private sector, and civil society. A voluntary Code of Good Corporate Governance is in place. Where progress in this area falls short is in the lack of self-reporting provisions and the under-utilization of integrity pacts (agreements in which companies pledge to comply with anti-corruption standards, then police each other).

Recommendations

1) Incorporate sentence-mitigation provisions into anti-corruption and corporate financial transparency laws, and provide channels for self-reporting.
2) Encourage and support integrity pacts in areas related to corporate governance and private sector corruption, such as procurement, taxation, permits, and financial reporting.

B. Internal controls

This area is largely governed by voluntary standards. Public companies are required to have internal audit, but there appears to be no professional oversight or standard setting here. The CGCG contains a number of international good practice norms concerning audit committees, ethics standards, and internal control systems but is not mandatory. The standards do include some general guidance on corruption. Company compliance appears uneven.

Recommendations

1) Support the development of an association and professional standards for internal audit, using IIA models.
2) Incorporate the CGCG more fully into mandatory regulatory norms, with enforcement by authorities such as the Ministries of Finance and Trade, OJK, and BI. In particular, raise mandatory standards and risk-based internal control requirements for large and public companies to those now required of banks and SOEs. Consider providing shareholder rights of action to enforce the Code.

3) Include more explicit corruption-prevention duties in the CGCG and the responsibilities of the internal audit function, audit committee, and BOC.

C. Integrity of financial statements

Indonesia has been working at full implementation of both IFRS and ISA. One can understand how competing priorities, insufficient skilled capacity, and the need to translate all standards into Bahasa Indonesia create challenges for timely implementation. But this is an area with clear benefits in terms of preventing corruption and encouraging foreign investment, and deserves a bigger push. Other issues here relate to the broader legacy of limited accountability, such as the relatively weak capacity for enforcement by courts and by the agencies charged with monitoring financial reporting, and the sanctions for accounting and audit violations that are set at less than deterrent levels. There also appears to be limited capacity to monitor and discipline accounting and audit professionals.

Recommendations

1) Adopt explicit prohibitions of the kinds of document manipulation identified in UNCAC 12(3).
2) Move to full convergence with current IFRS and ISA.
3) Adopt an explicit legal duty and safe harbor provision for auditors reporting instances of corruption to external authorities.
4) Stiffen penalties and enforcement for accounting and auditing violations, while investing in increased capacity by courts, financial reporting supervisors, and auditors to detect and deter malfeasance in financial disclosure that may help to disguise fraud and corruption.
5) Tighten rules on auditor independence and conflict of interest, including non-audit work, auditor interests in audited companies, and company hiring of former auditors.

Indonesia Laws, Regulations, Policy Documents Referenced:

Bank Indonesia Regulation No. 3/22/PBI/2001.

Bapepam Chairman Decision No. Kep-29/PM/2004 on establishment of the audit committee and implementation guidelines.

Bapepam Chairman Decision No. Kep-496/BL/2008 on establishment of the Internal Audit Unit.

Bapepam-LK regulation No.IX.I.5.

Code of Good Corporate Governance, 2006 (National Committee on Governance).

Government Regulation No. 60/2008 on the internal control government system.

Law of the Republic of Indonesia No. 8 /1995 on the Capital Market.
Law of the Republic of Indonesia No. 8/1997 on Corporate Documents.
Law of the Republic of Indonesia No.40/2007 Concerning the Limited Liability Company.
Law of the Republic of Indonesia No. 16/2009 on Tax Administration.
Law of the Republic of Indonesia No.21/2011 on the Financial Services Authority (OJK).
National Strategy of Corruption Prevention and Eradication (Nastra CPE).
Presidential Decree No 55/2012 on National Strategy to Prevent and Combat Corruption for 2012-2025.
Presidential Instruction No. 17/2011 on corruption prevention and eradication.
Regulation of the Audit Board of the Republic of Indonesia (BPK RI) No. 1/2007 on financial examination standards.

NOTES

[1] http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/indonesia/show-all.aspx.

[2] Jasin, Mochammed, "The Indonesian Corruption Eradication Commission," http://www.humanrights.asia/resources/journals-magazines/article2/0901/04the-indonesian-corruption-eradication-commission

[3] Haeril Halim,"KPK changes public attitudes toward graft," The Jakarta Post, Jan. 03 2014, http://www.thejakartapost.com/news/2014/01/03/kpk-changes-public-attitudes-toward-graft.html.

[4] Novianti Setuningsih,"Kernel Oil Exec Handed 3-Year Sentence in SKKMigas Graft Case," The Jakarta Globe, December 19, 2013, http://www.thejakartaglobe.com/news/kernel-oil-exec-handed-3-year-sentence-in-skkmigas-graft-case/. All currency conversions are based on inter-bank rate as of Feb. 1, 2014, from http://www.oanda.com/currency/converter/.

[5] World Bank, *Report on the Observance of Standards and Codes (ROSC): Corporate Governance Assessment, Indonesia* (April 2010) p.8.

[6] Presidential Decree No 55/2012 on National Strategy to Prevent and Combat Corruption for 2012-2025; http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/indonesia/show-all.aspx.

[7] Government comments; "Indonesian ministries get early-corruption warning system," August 26, 2010, http://www.istockanalyst.com/article/viewiStockNews/articleid/4442335. "Gratuity" seems to refer to gifts and facilitation payments, which are considered distinct from bribery (though closely related).

[8] IBL (2010), "Communication on Progress," http://www.ibl.or.id/index.php?id=static&page=Communication_on_Progress&lang=en.

[9] The sources of all standards are provided in footnotes to the tables presented in the section of the Review entitled *International Standards for Country Reports.*

[10] Bapepam Chairman Decision No. Kep-496/BL/2008. Nearly all such companies are also listed on the Stock Exchange(World Bank 2010: 9); http://www.iclg.co.uk/practice-areas/corporate-governance/corporate-governance-2013/indonesia.

[11] Bapepam-LK Regulation No. IX.I.5; Bapepam-LK chairman decision No. Kep-29/PM/2004 on establishment of the audit committee and implementation guidelines; http://www.iclg.co.uk/practice-areas/corporate-governance/corporate-governance-2013/indonesia. OJK is the consolidated financial services authority, which is in the process of assuming the regulatory powers of Bapepam, Bank Indonesia, and others.

[12] World Bank 2010: 20. OJK/IDX regulations also set out the criteria for non-affiliated directors and independent commissioners (including independence from major shareholders and other board members, no recent affiliations with the company, etc.), http://www.iclg.co.uk/practice-areas/corporate-governance/corporate-governance-2013/indonesia.

[13] ADB (2013), ASEAN Corporate Governance Scorecard, p.11-19.

[14] http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/indonesia/show-all.aspx.

[15] Deloitte (2012), Indonesian Tax Guide 2012,p.9, http://www.deloitte.com/assets/Dcom-Indonesia/Local%20Assets/Documents/Indonesian%20Tax%20Guide%202012.pdf; government comments.

[16] http://www.track.unodc.org/LegalLibrary/Pages/Home.aspx.

[17] http://www.ifrs.org/Use-around-the-world/Documents/Jurisdiction-profiles/Indonesia-IFRS-Profile.pdf.

[18] World Bank, *Report on the Observance of Standards and Codes (ROSC): Indonesia Accounting and Auditing* (updated April 2011) p.17.

[19] World Bank 2010: 18; ADB (2013): 11-19; World Bank 2011: 8.

[20] World Bank 2010: 18; ADB (2013): 11-19;World Bank 2011: 8; http://www.pwc.com/id/en/publications/assets/ifrs-psak-comparison-2012.pdf.

[21] Adoption of ISA is part of the continuing process of achieving compliance with the IFAC Statement of Membership Obligations (government comments).

[22] World Bank 2011: 8-9; World Bank 2010: 22; Bank Indonesia Regulation No. 3/22/PBI/2001; http://www.iclg.co.uk/practice-areas/corporate-governance/corporate-governance-2013/indonesia; Bapepam Chairman Decision No. KEP-431/BL/2012; IDX BOC decree No. Kep-306/BEJ/07-2004; government comments. BI's functions in this area, like Bapepam's, have been taken over by OJK.

[23] http://www.iclg.co.uk/practice-areas/corporate-governance/corporate-governance-2013/indonesia; government comments.

[24] http://www.track.unodc.org/LegalLibrary/Pages/Home.aspx.

Japan

1. Introduction

Japan, one of the foremost industrial democracies, faces a set of challenges familiar to many of its peers. Older social and political arrangements that aided its rise to pre-eminence are now causing drag in the form of political dysfunction, monopoly power, and corruption. For many years the second- and now the third-largest economy globally, Japan continues to innovate and to provide a highly attractive destination for foreign direct investment. All sectors enjoy healthy levels of economic freedom along with effective, non-discriminatory enforcement of contracts and regulations. Overt corruption, for example direct exchange of cash for favors from government officials, is reported to be rare in the domestic setting, and infrequent in the dealings of Japanese companies abroad. However, the influence of powerful networks in the political and economic systems have given rise to concerns that the systems are not open to competition at the highest level, but are instead managed in a form of "institutionalized corruption." The Liberal Democratic Party (LDP), having governed for most of the past six decades, enjoys privileged relationships with major banks and the upper echelons of big businesses. The financial sector in particular, though highly developed and effective, is reported to be plagued with growing political interference, and by seniority-based labor practices that constrain mobility. [1]

The Japanese industrial system has been characterized by tight networks of suppliers, buyers, and financial institutions, referred to as *keiretsu*. Many such networks exist, and are known for their extensive cross-shareholdings among group members, affiliated firms and banks. In this connection, large blocks of shares in major companies are owned by a stable group of shareholders made up of the companies' business partners including each group's "main" bank. Cross-shareholdings and stable ownership facilitate goodwill, information exchange, and mutual monitoring – and thus provide the foundation for long-term business relationships. In the early 1990s, some 70% or more of shares owned in Japan belonged to this category of affiliated stable investors or keiretsu members. Consequently, managers of Japanese firms have often not paid close attention to the concerns of financial investors who bought, sold, and held shares purely for financial purposes. This system is changing, however. Since 1990, stable owners, cross-shareholdings, and main bank arrangements have decreased. This is due to pressures from such factors as rising FDI, which creates pressure for more shareholder-oriented policies. For example, outside directors are increasingly involved in corporate governance, though still frequently drawn from associated institutions such as a company's bank, partner firms, and government.[2]

The cooperative business climate created inside these networks facilitates the award of contracts, employment, board positions, and other benefits within an exclusive group of local players. These arrangements not only reduce competition but encourage corruption. An example is the traditional practice of assigning retired government officials to top positions within Japanese companies, even in the same companies the officials once regulated (or contracted) – particularly in heavily regulated sectors including pharmaceuticals, construction, transportation, and banking. One outcome of such arrangements has been the rigging of bids on government public works projects. Government has attempted to rein in such practices by toughening the law on procurement fraud. Also, the National Public Service Act now prohibits government officials from seeking jobs in companies that they regulate or contract with, and prohibits retired government officials from seeking assistance or business from their previous government workplaces, for two years after retirement. Regulations on these matters took effect in 2008.[3]

Japan's Penal Code covers both active and passive bribery, and company directors who accept bribes are subject to fines and imprisonment. The Unfair Competition Prevention Law (UCPL)[4] prohibits bribery of foreign officials. The OECD notes that there have been only three prosecutions since the provision took effect in 1995, and there was a later foreign corruption scandal leading to the 2012 conviction of Japanese consulting firm executives for bribing officials in Viet Nam in connection with road construction contracts.[5]

2. General efforts to prevent corruption involving the private sector

Japan does not have a central anti-corruption agency or ombudsman at the national level, though it does have other institutions that perform similar functions. For example, some cities have established municipal ombudsman offices, and the national government has a bureau dealing with problems encountered by businesses, both domestic and foreign. The Office of Trade and Investment Ombudsman receives complaints about government regulations that present export or investment problems in Japan and works to improve regulations or give guidance in order to improve access to the Japanese market. In addition, the Administrative Counselling System in the Ministry of Internal Affairs and Communications performs many functions similar to that of a national ombudsman office, though its jurisdiction covers administrative grievances rather than anti-corruption. Government has been responsive to corruption problems in other ways, for example toughening provisions against collusion in procurement in the 2006 amendments to the Act on Elimination and Prevention of Involvement in Bid-Rigging. Also, the police, prosecutors, and agencies such as the National Tax Agency and Financial Service Agency's

Securities and Exchange Surveillance Commission are reported to be coordinating more closely and sharing information. [6]

The government has also taken several steps over the years to limit foreign bribery by Japanese companies. An early move here was the 1994 amendment to the UCPL outlawing bribery of foreign officials. Further, the Japan Federation of Bar Associations established the Committee on International Criminal Law Legislation that has taken on responsibility for improving lawyers' proficiency in anti-corruption standards. The Federation in 2011 held a training seminar on the OECD Convention on Combating Bribery of Foreign Public Officials and the UCPL, and also sponsored a workshop on international corruption for its members jointly with the International Bar Association, OECD, and the UN Office on Drugs and Crime. Japan's Whistleblower Protection Act (implemented in 2006) includes foreign bribery as an offense for which the Act protects whistleblowers against dismissal and unfair treatment.[7]

The Ministry of Economy, Trade and Industry (METI) plays the lead role in preventing foreign bribery by Japanese companies and in raising awareness of this crime. METI has a direct official channel with private entities, the "Reporting Desk" which aims to gain information of foreign bribery not only from private entities but from whistleblowers. In 2010, METI issued *Guidelines to Prevent Bribery of Foreign Public Officials*.[8] One of the guidelines provides that, when bribery is discovered, "the company should try to report the case to applicable governmental agencies etc. in a prompt fashion." [9] METI held seminars on this topic (jointly with the Japan Patent Office) for over 2,000 private sector representatives across 19 prefectures. METI also has business and chamber of commerce representatives on its policy council. An office of the Ministry provides advice on compliance with UCPL. The OECD review found Japanese multinational enterprises and business associations to be keenly aware of the bribery offence under the UCPL, along with the METI Guidelines and the OECD Convention. By contrast, according to the review, SMEs had very little awareness of these matters, and METI stated that it had no policy of outreach to this segment of the business community (OECD 2011: 33-37). Government reports that SMEs have attended METI seminars, and the Ministry has begun to support publicity activities for SMEs on preventing bribery of foreign public officials.

METI has other relevant initiatives in which it cooperates with the private sector, including the Corporate Reporting Lab to enhance disclosure on corporate governance, and the Corporate Financial Executive Committee that convenes to develop policies of financial reporting and related matters. METI's efforts here are partly a response to relatively stagnant investment in the Japanese equity markets in the last several years.[10]

Regarding incentives for prevention and self-reporting such as sentence mitigation, there is no specific sentencing guideline here. However, Japan reports that it recognizes self-reporting as a mitigating factor in practice when prosecutors decide on charges to pursue and judges impose sentences. The METI *Guidelines* state: "It has been made clear in a court decision that the failure to develop adequate internal control might result in the corporate manager being held accountable for the violation of the obligation to use the care of a good manager under civil law."[11]

International standard[12]	**Compliance by member country**
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	METI reaches out to private sector on anti-corruption and corporate governance, raising awareness and facilitating implementation of new legislation.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) METI, Trade and Investment Ombudsman, Internal Affairs bureau, municipal ombudsman offices and others provide reporting and complaint channels. 2) No specific penal law provision on sentence mitigation for self-reporting or preventive measures, but these are used in practice and included in METI Guidelines on foreign bribery.
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) METI works with private sector to implement UCPL and other laws and policies. 2) JICPA and Bar Federation train and raise awareness on disclosure, foreign bribery, and other matters. 3) Tokyo Stock Exchange issued Corporate Governance Principles.

Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	No indication that these are used to any significant extent.

3. Internal controls

The Commercial Code now provides large Japanese firms two choices in terms of their internal corporate governance structure: the traditional auditor system or the newer committee system. The first is a two-tier board system in which the board of directors is responsible for strategic policy making and overseeing top management decision-making, while the board of statutory (company) auditors monitors the board of directors. In practice, a majority of directors in this system are often insiders appointed from the ranks of employees as a reward for long service. Such directors are sometimes viewed as *de facto* managers and thus subordinate to the CEO. As a result, the board of directors under the traditional auditor system is sometimes seen with skepticism. In the committee system, by contrast, the board of directors is responsible for monitoring the management, which is carried out by executive officers. Hence, there is a clear legal separation between monitoring and execution functions. This is the system used in the US. Again, in Japanese practice, directors are often concurrently appointed as executive officers, and so the legal separation is not maintained. The committee system requires three board committees: nominating, audit, and compensation committees. Each committee consists of at least three directors of which a majority must be outsiders. In the first two years following the Commercial Code reform that permitted the above choice of systems, only 70 of the 1500 large companies listed in the relevant part of the Tokyo Stock Exchange adopted the new committee system (Yoshikawa 2007: 74-5).

A. Internal audit

There is no explicit legal requirement for all companies to establish an internal audit function. In the traditional two-tier system, however, the statutory (company) auditors perform a role (referred to as *kansayaku*) that combines aspects of internal audit, an audit committee, and external audit (for companies not required to be audited by external auditors).[13] Companies do maintain an internal audit function, whether under the two-tier board or committee system – although it is unclear how widespread this is. Japan has a chapter of IIA, which organizes this professional sector and upholds global standards.[14] Internal auditors' professional duties are defined in the IIA-Japan's "Standards for

Internal Audit" and "Practice Advisories for Standards for Internal Audit." There are no provisions in those standards and practice advisories to impose duties to prevent illegal acts.[15] Companies that have a board of directors must have a statutory (company) auditor, and large firms (see below) must have a board of statutory (company) auditors (Companies Act, arts.2, 327(2), 328(1)).

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	Though not legally required for all companies, internal audit is practiced at least in large companies. Internal audit tasks are handled at least in part by company auditors. Companies with boards of directors must have company auditors.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect "illegal acts" in the books and records of companies, including bribery and other forms of corruption.	1) No explicit legal standard, but IIA-Japan promotes best practice standards for professional members. 2) Provided by IIA standards.
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	1) and 2): Tasks are handled by company auditors. 3) and 4): Company auditors report to board of directors on illegalities.

B. Audit committee

The Companies Act[16] provides for both the two-tier and committee structures. In the latter, each committee is required to have three members appointed from among the directors, with the majority being outside directors.[17] An audit committee member may not concurrently serve as an executive officer or executive director of the company or its subsidiary, nor as an accountant ("accounting advisor") or employee (art.400). The audit committee is to have these responsibilities (art.404): auditing the performance of executive officers, directors, and accountants; preparing audit reports; and nominating external auditors (and proposing their removal). If committee members find that executive officers or directors engage in misconduct, violate laws, or commit other irregularities, they are to report this immediately to the board of directors (art.406). They may also demand that the officer cease such actions if they are likely to cause substantial harm to the company (art.407). Likewise, executive officers must report immediately to the audit committee any fact likely to cause substantial harm to the company (art.419).

The alternative structure, the board of auditors, performs similar functions (arts.381, 382, 390). The board of auditors is comprised of the company auditors, and the same board participates in nominating the external auditor, sets audit policy, and prepares audit reports. Any "Large" company (stated capital of JPY 500 million (USD 4.9 million) or more, or total liabilities of JPY 20 billion (USD 190 million) or above) must have its own external (accounting) auditor and, in case it is a public company at the same time, maintain a board of company auditors comprised of at least three company auditors (Companies Act arts.2, 328, 335). The company auditors operate under the same conflict-of-interest strictures as audit committee members; at least half of the members must be "outside" auditors, i.e. having never been directors, officers, accountants, or employees of the company or its subsidiaries.

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	Per Companies Act: 1) Companies may choose board of auditors or audit committee. 2) Audit committee to have a majority of outside directors. Board of auditors to be made up of company auditors, with half being outside auditors.
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers, employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	Per Companies Act: 1) Audit committee nominates and supervises external auditor. Board of auditors participates in nominating external auditors and sets policy. 2) Audit committee and board of auditors supervise executive officers. 3) No explicit provision. As a matter of fiduciary duty, however, the directors/board of directors should provide such guidance to staff as appropriate if the company's situation reasonably requires them to do so. 4) Audit board/committee members to report director misconduct to all directors/board, or order the director to cease if likely to harm the company (arts.382, 385, 406, 407). 5) No explicit provision. As a matter of fiduciary duty, however, the directors/board of directors should provide such channel as appropriate if the company's situation reasonably requires them to do so.

C. Internal control and compliance systems

The Companies Act (arts.362, 435-437) touches upon internal controls. The board of a "Large" stock company (as defined above) must itself decide on key matters of internal control, and may not delegate such decisions. A stock company must prepare an annual business report, which includes the description of the internal control matters decided by the board of directors – this report is to be audited and provided to the shareholders.[18]

The Financial Instruments and Exchange Act (FIEA) introduced an internal control reporting system for listed companies, beginning in 2008. Under this system, an assessment by relevant managers of internal controls over financial reporting, as well as the auditing of this assessment by certified public accountants, are required in order to ensure the reliability of financial reporting. In the two years following the introduction of the system, the FSA reviewed the standards and enforcement of internal control. As a result, revised standards were developed and have been applied to the assessment and auditing of internal controls beginning in 2011. The OECD points out that the reporting requirements under FIEA apply to less than 1% of all Japanese companies.[19]

The FIEA requires companies publicly listed on a Japanese stock exchange (and offering shares or financial instruments with certain characteristics of investment securities) to submit an Annual Securities Report together with an Internal Control Report (arts.24, 24-4-4). The latter report consists of an assessment of each company's internal controls over its financial reporting. These reports must be audited and certified by a certified public accountant or audit firm (art.193-2). The audited reports are to be made available to the public by the FSA, and maintained in that way for five years (art.25(1)). Failure to submit a required Internal Control Report, or submitting a report containing false statements "on important matters" is subject to imprisonment ("with work") for up to five years and fines up to JPY five million (USD 49,000) for the responsible officer, and fines up to JPY 500 million (USD 4.9 million) for the responsible entity (audit firm and/or client) (arts.197-2, 207). These requirements are part of Japan's response to the kinds of corporate scandals that led to the US Sarbanes-Oxley Act, and are sometimes referred to as "J-SOX."[20]

The Business Accounting Council of FSA issued *Standards for Management Assessment and Audit concerning Internal Control over Financial Reporting*. The Standards require a business manager to design and effectively implement internal control processes in order to achieve four objectives: effectiveness and efficiency of business operations, reliability of financial reporting, compliance with applicable laws and regulations relevant to business activities, and the safeguarding of assets. Managers' duties thus include ensuring the reliability of financial statements and the information that could have a material effect on financial statements, and assessing the effectiveness of internal controls in meeting this objective. The Standards include provides “risk assessment and response” and “monitoring” as two of six basic components of internal control.[21]

In addition, the Tokyo Stock Exchange’s *Principles of Corporate Governance*,[22] applicable to listed companies, provide standards for disclosure and internal control (Principle 4). Corporate governance for listed companies should ensure timely and accurate disclosure so that shareholders receive information sufficient to evaluate operational conditions and material events taking place during the intervals between periodic disclosures. This requires enhanced information disclosure as well as the maintenance of internal systems to secure the accuracy and promptness of disclosure.

The METI *Guidelines to Prevent Bribery of Foreign Public Officials* encourage companies to adopt compliance programs and preventive measures:

> [I]t is necessary to augment the effect of measures for preventing bribery of foreign public officials and to improve the effectiveness of internal control by, for instance, establishing a compliance program capable of appropriate prevention of bribery of foreign public officials and conducting dissemination of knowledge and education activities, using (these) Guidelines etc., regarding the offense of bribery of foreign public officials.

The Guidelines provide that companies involved in international business transactions should stipulate no-bribery standards and contract clauses to their agents, and carefully review agency fees to ensure that they do not include expenses related to bribery. Companies should also facilitate coordination between their subsidiaries (at least those they control) and the compliance supervisor of the main office. Sanctions should be clarified in advance, especially for illegal acts, and the top corporate officer should be actively involved addressing any such violations. That officer should at least be personally involved in the development and reviews of compliance programs, damage control in the face of trouble, feedback reports on audit results, and review procedures based on them. Education and training should be offered to employees involved in international business transactions. Further, internal policies setting limits on gifts and entertainment are also recommended (e.g. scale, frequency, occasions).[23] METI conducts annual orientation sessions for corporate staff including legal officers on improving internal controls and clarifying basic policies in this area (ADB/OECD 2011: 62). In addition, the Japanese government reports that it considers the existence of internal controls, ethics and compliance systems in its decisions to grant public procurement contracts (OECD 2011:41).

A few other initiatives are aimed at strengthening internal controls. The Financial Services Agency, the Japanese Institute of Certified Public Accountants, and Keidanren have established a common inquiry counter for the internal control reporting system, through which they have responded to inquiries. The Japan Securities Dealers Association (self-regulatory authority) has established a working group on internal control systems concerning prevention of insider trading, and FSA has attended meetings and exchanged views on insider trading. The Japan Industrial Standards' Social Responsibility Guideline (JIS Z 26000) advises companies to ensure their leadership sets an example of integrity and commitment, and provides encouragement and oversight for implementation of anti-corruption policies. The Guideline also states that each company should support its employees and representatives in their efforts to eradicate bribery and corruption, including by provision of training and incentives for progress.

International standard	Compliance by member country
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees. 4) Risk-based approach: • Individualized assessment of risks to the enterprise, including corruption risks. • Regular monitoring and re-assessment of corruption risks.	Listed, large, and financial companies: 1) FIEA and TSE Corporate Governance Principles: Management assessment report on effectiveness of internal controls, and audit of the assessment, to be submitted to FSA and made available to the public. Companies Act: The board of directors of large companies must decide on key matters of internal controls and report on them to the shareholders. 2) FIEA and TSE Principles: Internal controls on financial reporting are the focus of the assessment and audit. Business Accounting Council (FSA) Standards require effective internal controls. 3) BAC-FSA Standards require risk assessment and review. 4) METI Guidelines require monitoring of foreign bribery risks, and preventive steps.

Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements. 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations. 4) Require for third-party representatives, consultants, or agents: • Written contract, adherence to company ethics standards and anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	Listed, large, and financial companies: 1) FIEA, TSE Principles, BAC-FSA Standards: These issues Included in assessment report on internal controls and audit of the report. 2) METI Guidelines and training reinforce the need for internal controls to prevent bribery of foreign public officials. 3) and 4): METI Guidelines address these issues concerning bribery of foreign officials in business transactions.
Enforcement, including sanctions for failure to comply.	Enforcement in general via regulatory pressure by FSA, Tokyo Stock Exchange, and procurement authorities. Violation of Internal Control Report requirement, per FIEA, subject to corporate and individual fines and imprisonment.

4. Integrity of financial statements

A. Accounting

1. Financial records

The Companies Act (art.432) requires all stock companies (corporations) to prepare accurate account books in a timely manner and to retain them, along with other business records, for ten years after closing the accounts. The Act (art. 429) prohibits various false statements and entries, including in accounts, financial statements, and audits. The ongoing convergence of Japanese GAAP with IFRS reinforces the prohibitions on false accounting. The OECD (2011:29-33) pointed out in its Phase 3 report that Japan's legal provisions on document retention were somewhat vague and failed to specify the records required (as stipulated in the OECD Convention, art.8.1). As a result, it would be possible for false statements in certain accounting records to be overlooked or amended in disclosure statements, so that they would fail to trigger liability for a false disclosure. The report also noted that Japan had not as yet detected foreign bribery through the enforcement of books and records requirements, accounting standards, auditing standards, or financial statement disclosure documents.

Japan addressed these points in an official notice by FSA to JICPA in 2005, entitled *Prevention of Bribery of Foreign Public Officials in International Business Transactions*. The notice clarified that it is illegal under the securities law (now FIEA) for companies subject to audit to establish off -the-books accounts, to trade off the books, to carry out inadequately identified transactions, or to record non-existent expenditures for the purpose of engaging in or hiding bribery of foreign officials. Further, under FIEA (art.197), any person who submits annual securities reports containing false statements is subject to imprisonment with work for up to ten years and fines of up to JPY 10 million (USD 98,000).

International standard	Compliance by member country
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	Corporations to keep account books and related materials for 10 years.
Prohibitions (UNCAC 12(3), OECD Convention 8(1)), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	1) False statements and entries prohibited by Companies Act and FIEA. 2) Retention rule in Companies Act covers this. Improper destruction triggers the directors' liability under the articles 423 and 429 of the Companies Act. 3) through 6): Explicitly outlawed by FSA notice on Prevention of Bribery, FIEA.

2. Financial reporting requirements

Japanese corporations are required to prepare annual financial statements in the form of balance sheet, profit and loss statement, and other statements prescribed by ordinance of the Ministry of Justice (Companies Act, art.435). In addition, limited liability companies must prepare financial statements for their members. In case of corporations, summary financial statements are to be published in newspapers or gazettes. Further, under the FIEA, listed companies must submit quarterly financial statements to the FSA (OECD 2011:29-33).

The Accounting Standards Board of Japan (ASBJ) is the national private-sector accounting standard-setting body. All accounting standards set by the ASBJ are subject to endorsement by the FSA. The IASB and the ASBJ have been working together to achieve convergence of IFRS and Japanese Generally Accepted Accounting Principles since 2005. That agenda was formalized in 2007 with the Tokyo Agreement. Voluntary application of IFRS for consolidated financial statements by companies that meet certain criteria has been permitted since March 2010. As of early 2014, 34 companies have either started to use IFRS or have publicly announced their intention to use IFRS as a basis for preparing the consolidated financial statements required by the FIEA. In late 2013, the FSA revised its requirements to encourage further application of IFRS in Japan. As a result, the number of companies eligible to apply IFRS was increased from 621 to 4,061, covering virtually all listed companies and unlisted companies preparing consolidated financial statements for listing purposes. Such companies may use IFRS if they disclose their specific efforts in this area and designate the appropriate staff and set up the necessary structure to achieve compliance. The FSA designates the IFRS that are to be adopted into Japanese regulations and therefore may be used on a voluntary basis by the eligible companies. Reconciliation between IFRS and Japanese GAAP is not required, though certain supplementary disclosures are necessary in the financial year when transition to IFRS is made. The mandatory application of IFRS by listed companies and others is contemplated for the future. The use of IFRS for SMEs by non-listed companies has not yet been formally considered – those firms are to follow Japanese GAAP.[24]

Regarding the rules on contingent liabilities, "materiality" is not specifically defined. However, contingent liabilities must be disclosed if they are obligations for compensation pertaining to litigation or other liabilities that have not arisen in reality but may be borne by the business in the future. As for contingent liabilities held by a consolidated company, the content and the amount of those liabilities must be disclosed in the financial statement notes. Balance sheet items of significant affiliated companies, including total current assets and total current liabilities, must be stated in the notes. In cases where there is any "Special Purpose Company Subject to Disclosure," the notes must include the outline and transaction amounts for that company, and any other significant matters.[25]

International standard	Compliance by member country
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) IFRS are being adopted on a rolling basis. Voluntary use is permitted for listed companies and others preparing consolidated financial statements. 2) Other companies to use Japanese GAAP. 3) Consolidated disclosure of affiliated company accounts and basic information on special-purpose companies required.
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) Disclosure required though "materiality" not defined. 2) Prohibited by FSA notice.

B. Audit

1. Auditing requirements

Both the Companies Act and FIEA contain auditing requirements. The former (arts.2, 389, 436, 439) requires audits by an independent CPA for the following:

- Large companies with capital stock of JPY 500 million (USD 4.9 million[26]) or more, or liabilities of at least JPY 20 billion (USD 195.3 million);
- Companies that adopt the committee-based corporate governance system.

Other companies may appoint external auditors on a voluntary basis. External auditors must be CPAs or audit firms; they are appointed by shareholder resolution and dismissed the same way or by unanimous decision of the company auditors or audit committee (arts.329, 337-340). Other entities to be audited under separate enactments include political parties receiving public funds, cooperatives meeting a defined threshold, and investment partnerships and corporations.[27]

Under the FIEA (art.193-2), annual financial statements must be audited by an independent CPA in accordance with Japanese Generally Accepted Auditing Standards (GAAS) and submitted to FSA. These audits are required of all companies that issue shares listed on a financial instruments exchange along with companies that have filed a registration statement or that have a specified number of shareholders. The independent auditor's report is to express an opinion as to the fairness of the presentation of the company's results of operations, financial position, and cash flow – and certify the statements as appropriate – in accordance with Japanese GAAP. Listed companies must also submit quarterly financial statements, which must be reviewed by an independent CPA.[28] Listed companies are required to submit a Confirmation Letter of Annual Securities Report, confirming that statements contained in the annual securities report are appropriate under the Financial Instruments and Exchange Act and related regulations (Article 24-4-2 Para. 1 of FIEA). The auditor must also describe internal control systems and testing procedures.[29]

Japanese Generally Accepted Auditing Standards are based on the ISA. They are comprised of Auditing Standards codified by the Business Accounting Council (under the FSA), and the Auditing Standards Committee Statements (ASCS) issued by JICPA.[30]

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	Audit controls appear robust for listed companies and some others. Independent audit not required of all companies.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	Per Companies Act and other relevant laws: 1) Large and/or listed corporations, and those with committee-based governance to have financial statements audited by independent CPA. In case of listed corporations, FSA makes audited reports available to the public, while, in case of other corporations, financial statements are published in summary form. 2) Other firms may choose to have external audit or not to have it. No special SME rules.
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	Japanese standards are based on ISA, and ASCS include ISA 240 and 250.

Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks. 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	1) Per Companies Act, company auditors to state opinion. Per FIEA, external auditor to state opinion on fairness of presentation in financial statements and consistency with accounting standards. Per audit standards, auditor to detail internal controls and tests. 2) Per Companies Act: Board of directors to approve financial statements. FSA notice prohibits false statements concerning company accounts.

2. Auditor reporting of improprieties

The Companies Act (art.382) provides that, if company auditors discover that directors are engaged in misconduct, or are likely to do so, or if they discover gross improprieties or illegalities, the auditors are to report this immediately to the company directors or board of directors (depending on the corporate governance structure). This provision does not apply to a non-public company that limits audits to accounting matters only (art.389). Where a director is engaged (or is likely to be) in some act contrary to law or the purposes of the company, and if the act is likely to “cause substantial detriment” to the company, the auditors may demand that the director cease such act (art.385). This last provision contemplates possible court action by the auditor to restrain the director. A reporting rule similar to art. 382 is applied to accounting (external) auditors (art.397).

The rules applicable to firms reporting under FIEA (listed, large, or committee-governed companies) include an external reporting duty. If the auditor discovers, in the course of an audit, any violation of laws or regulations, or any other fact that materially affects the adequacy of the company's financial statements, the auditor must immediately give the company notice to this effect (in a prescribed format). The notice is to state the details of the matter and require appropriate corrective steps to be taken. If the company has not taken measures to rectify the matter after a given lapse of time (fixed by Cabinet Order), and the auditor finds it necessary to prevent the foreseen material impact on the company, the auditor is required to submit an opinion on the matter to the FSA (on behalf of the Prime Minister), giving notice of this to the company (art.193-3). Failure to do so is subject to fines (art.208-2).

These provisions have been applied to the audit attestation of financial statements since 2008 and are embodied in the relevant JICPA audit standards (ASCS 11 and 35), corresponding to ISA 240 and 250 dealing with illegality and fraud.[31] The rules state that auditors need not report to FSA if the matter is "clearly inconsequential or trivial" in light of its impact on the auditor's assurance of the adequacy of the company's financial statements. FSA, pursuant to its authority to supervise the stock markets, has the authority to conduct an investigation, levy administrative penalties, and request law enforcement assistance in response to auditor reports under FIEA art.193-3. In its Phase 3 Report, OECD (2011: 29-33) expressed concern about a lack of clarity in the standards of materiality to be used by the auditor in determining whether issues are sufficiently consequential to pursue. The question had been raised in Phase 2 as to whether bribes to foreign officials would meet the standard of materiality applicable to the offense of making a false statement in disclosure documents. A 2008 clarification by JICPA states that the issue is to be decided by the auditor on a case-by-case basis. Professionals were reported as being doubtful that facilitation payments would meet the materiality standard and thus be detected in financial reporting and subjected to legal sanctions. There is no indication that this has essentially changed since 2011. Also important, the CPA Act (art.27) punishes auditor violations of confidentiality with fines and imprisonment, and thus a conflicting duty such as just discussed must be narrowly interpreted.

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	Companies Act requires company auditors to report to the board/directors any illegality or impropriety, and permits auditors to demand that it cease; accounting (external) auditors to report to the company auditors any impropriety. FIEA requires external auditors to report details of legal violations or other material facts and to require remedial action.
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").	1) FIEA requires auditor to report to FSA if company does not correct the material legal or other violation within a given time. Questions remain about timeliness and whether facilitation payments or even bribes fit the materiality standard. 2) No express safe harbor provision. Auditors penalized for breach of confidentiality per CPA Act.

C. Professional standards and independence

The Certified Public Accountants Act (CPA Act)[32] provides the basic framework for the accounting and audit profession in Japan. The Act addresses the scope of services to be provided by professionals, the CPA examination and qualification requirements, establishment of audit corporations, and other matters. The Act provides for the establishment of the JICPA under the authority of the FSA, which oversees the profession. CPAs are required to undergo continuing professional education to improve competency, as provided by the JICPA (CPA Act art.28 and Cabinet Office Ordinance).

The CPA Act also deals with major issues of discipline and sanctions (to be applied by FSA), such as for an auditor who attests as accurate financial documents containing falsehoods, mistakes or omissions, whether intentionally or negligently (arts.29-31, 34-21). The 2003 amendments to the CPA Act supplied a legal basis for quality control review, which is monitored by the Certified Public Accountants and Auditing Oversight Board (CPAAOB), an independent regulatory commission established within the FSA and appointed by the Prime Minister. In addition to quality control review, the CPAAOB exercises professional examination and disciplinary authority.[33]

JICPA operates within the framework of the CPA Act. It conducts quality control review of financial statement audits as part of its self-regulatory function. In response to corporate scandals that weakened the credibility of auditors, JICPA strengthened the review system in 2006, setting up a special center and registration system for audit firms engaged in listed company audits. The JICPA Ethics Committee, established under the amended CPA Act, includes both professional and outside members. The JICPA Code of Ethics is consistent with IFAC/IESBA standards and has been revised several times since 2000. The Institute also has committees on investigations and discipline, which act on the basis of their own information or in response to public complaint. JICPA's Audit Practice Monitoring Board is tasked with ensuring the objectivity and transparency of JICPA's monitoring activities, as well as the effectiveness of the investigative and disciplinary system. The Board includes distinguished individuals drawn from outside the profession, e.g. from industry, the stock exchange, and academia.[34] JICPA is authorized under its Bylaw (rules 50-51) to impose disciplinary measures.

The CPA Act (arts.24 et seq. and 34 et seq.) provides safeguards for auditor independence. Individual CPAs may not provide audit services to a company in which the CPA was an employee, or the CPA or the CPA's spouse was an officer responsible for financial matters, or the CPA has other "substantial interests." The latter include the CPA or her/his spouse:

- within the past two years being a government official whose duties were closely related to the affairs of the audit client;
- owning stock, or having a financial relationship to the company such as creditor;
- providing tax services to the client firm;
- serving as a director of an affiliated company of the audit client within the past year or being an employee at the time of the audit.

Similar restrictions apply to audit corporations (art.34-11), which cannot audit companies in which the audit firm has investments; companies where a partner involved in the audit becomes an officer of the audited company or affiliate; or companies in which the audit corporation (i.e. partners and their spouses) has other "substantial interests" in the client company as described above (art.34-5). Audit firms are not permitted to provide audit clients (i.e. companies that require audits under FIEA or the Companies Act) such non-audit services as accounting and preparation of financial documents, appraisal or actuarial services, services related to financial information systems, or internal audit outsourcing services. Individual CPAs are required to follow a similar rule (art.24-2). By Cabinet Ordinance, the safeguards of auditor independence are made somewhat stricter for audits under FIEA (e.g. other relatives besides spouses are included). [35]

Accounting auditors are selected by resolution of a shareholders' meeting.[36] The JICPA Code of Ethics and related guidance provide that each individual CPA and engagement partner of an audit corporation must rotate for particular audit engagements of listed companies and certain large companies at least every seven years, with cooling-off periods of two years. Partner rotation is required for the FIEA audits and certain large company audits pursuant to the Companies Act (CPA Act arts. 24-3 and 34-11). JICPA established a self-regulatory standard for firms auditing 100 or more listed companies: a five-year rotation with a five-year cooling-off period for the lead engagement partners and the relevant quality control review partners.[37] Further, when a CPA has provided audit-certification work, she/he may not become a member of the board of the client company until after the accounting period following that covered by the audit (CPA Act arts. 28-2, 34-14-2 and Ordinance).

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) CPA Act and JICPA provide clear and rigorous standards for accountant qualification, discipline. 2) JICPA Code of Ethics conforms to IFAC/IESBA requirements.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	1) Companies Act provides for appointment and dismissal by shareholder resolution (or dismissal by unanimous decision of company auditors/audit committee). 2) through 4): CPA Act provides for rotation, restricts non-audit work, employment, and financial interests in audit client. Guidance for listed firms under FIEA is more stringent. 5) Limits on former auditors joining corporate board.
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) and 2): Auditors must be qualified CPAs meeting all qualification, training, ethical standards. 3) Direct supervision and quality control by JICPA, under FSA authority. Monitoring of professional governance and control by CPAAOB, an independent government agency. 4) Professional discipline exercised by committees of JICPA, overseen by JICPA board with majority external membership. Professional standards defined by CPA Act and codes administered by JICPA.

D. Enforcement

Sanctions related to financial reporting and auditing are provided in the Companies Act, the CPA Act, and FIEA. Under the Companies Act (art.429), directors, accountants, and auditors (and audit firms) are liable for damages caused to third parties if they knowingly or through negligence make false statements or records with respect to important matters to be included in the financial statements or audit reports. The same persons except external auditors are liable to imprisonment (with work) for up to ten years and fines up to JPY 10 million (USD 98,000) for committing certain acts in breach of their duties. The breach must be for the purpose of harming the company or promoting their own or a third party's interests, and must result in financial damage to the company (art.960 (1)). Other instances of directors, accountants, or auditors making false statements to shareholder meetings or to a court in relation to issuing shares of stock, etc. are subject to imprisonment up to five years and fines up to JPY 5 million (USD 49,000) (art.963). The solicitation or acceptance of bribes by any of these persons in connection with their duties is subject to the same penalties (and similar penalties for the bribe-payer) (art.967).

Under the CPA Act, accountants and auditors are subject to disciplinary action (art.29) including warning, suspension for two years, and termination of registration. These may be applied by FSA (on behalf of the PM) where a CPA has intentionally attested as accurate financial documents containing misstatements, errors or omissions or through negligence attested such documents where they contain *material* misstatements, errors, or omissions (art.30). Other grossly inappropriate instances of professional conduct are also subject to such penalties, and a "surcharge" up to 150% of the audit fees charged can be levied (art.31). A person providing audit attestations without being a qualified CPA is subject to fines up to JPY 2 million (USD 20,000) and imprisonment for up to two years – and if the auditor is acting on behalf of an audit firm, that firm is subject to the fines as well (arts.50, 53-4). Breach of confidentiality by an auditor is subject to imprisonment for up to two years and fines up to JPY 1 million (USD 10,000) (art.52).

Under FIEA, falsification of certain disclosure documents is subject to fines of up to JPY 10 million (USD 98,000) and imprisonment for up to ten years for individuals, and fines up to JPY 700 million (USD 6.8 million) for companies (arts.197, 207). Failure to report or making a false report to FSA in connection with audit attestation is subject to imprisonment for up to six months and fines up to JPY 500,000 (USD 5,000). An auditor failing to make a report to FSA on illegalities discovered in an audit, or making an improper report, is subject to a "non-penal" fine of up to JPY 300,000 (USD 3,000) (art.208-2). Certain other violations may result in lesser fines.

The Securities and Exchange Surveillance Commission reviews disclosure statements and refers cases of material misstatement to the Prime Minister and the FSA Commissioner for administrative sanctions (FSA Establishment Act, art.20). The FSA Commissioner holds hearings and decides whether to order payment of administrative monetary penalties. The SESC files criminal charges when offenses are in evidence (FIEA, art.226). In cases concerning violation of accounting standards, the SESC investigates.

If it finds misconduct that impairs the fairness of trading, it recommends to the Prime Minister and the FSA Commissioner the imposition of administrative monetary penalties, and files criminal charges with the public prosecutor, as appropriate (FIEA, art.226). The table below presents the results of these procedures for the period 2010 through 2012.

	2010	**2011**	**2012**[38]
Administrative action taken against	3 individuals 16 companies	1 individual 10 companies	9 companies
Administrative fines levied	JPY 1.9 billion (USD 18.5 million)	JPY 570 million (USD 5.6 million)	JPY 722 million (USD 7 million)
Criminal charges: false statements in securities report	1	4	0
Criminal penalties applied	3 years JPY 12 million (USD 117,000)	2 years JPY 7 million (USD 68,000) (other sentences pending)	

International standard	Compliance by member country
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2): Penalties for accounting and audit violations are stringent, though there is little evidence in reports to date that they have been used effectively against corruption.
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) and 2): Falsification of disclosure documents subject to fines approaching USD 100,000 (individuals) and USD 7 million (companies) per FIEA, and payment of damages to third parties per Companies Act. Imprisonment for up to 10 years applies where falsification is with intent to harm company or benefit third parties. JICPA sanctions also apply. 3) Enforcement actions have resulted in fines and imprisonment.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) and 2): Falsification in audit of disclosure documents subject to fines approaching USD 100,000 (individuals) and USD 7 million (companies) per FIEA, and payment of damages to third parties per Companies Act. Imprisonment for up to 10 years applies where falsification is with intent to harm company or benefit third parties. JICPA sanctions also apply. 3) Enforcement actions have resulted in fines and imprisonment.

5. Conclusion and recommendations

A. General efforts to prevent corruption involving the private sector

A number of government agencies and professional organizations in Japan work with the private sector on efforts to combat business-related corruption. METI reaches out to companies on anti-corruption and corporate governance, raising awareness and facilitating the implementation of new legislation such as UCPL. The large population of Japanese SMEs has not been a target of such efforts, but this is reported to be changing. The Tokyo Stock Exchange has issued Corporate Governance Principles for listed companies. Complaint channels are provided by the Trade and Investment Ombudsman and other institutions. Incentives for preventive action and self-reporting, such as sentence mitigation, are not provided by law but are reported to be available. The accounting and legal professions – led by JICPA and the Bar Federation – train members and raise awareness on disclosure, foreign bribery, and other matters. Integrity pacts do not appear to play much of a role in private sector anti-corruption efforts.

Recommendations

1) Strengthen awareness of UCPL, UNCAC, and the OECD Convention among SMEs. Part of this effort could be the development of an SME governance or business ethics code addressing corruption – particularly bribery of foreign officials.
2) Support the use of additional tools, including integrity pacts, in such areas as outbound FDI and political campaign finance.

B. Internal controls

Legislative reforms and corporate codes instituted over the past decade address the need for internal controls reflecting best international practice. Thus, Japan has made the option available for companies to choose a committee system, more typical of US and Western companies, in addition to the traditional two-tier board system. Though not legally required for all companies, internal audit is practiced at least in large companies. Internal audit tasks are handled at least in part by company auditors (companies with a board of directors must have one or more company auditors). The role of the audit committee within the newer governance structure includes nominating the external auditor and supervising management and accounting. Providing guidance or reporting channels on corruption matters is not explicitly stipulated in the Companies Act; as a matter of directors' fiduciary duty, however, directors/board of directors should provide such guidance or channels as appropriate if the company's situation reasonably requires them to do so. These roles are similar to those of the older-model audit board. In case of the newer governance structure, the audit committee is required to have a majority of outside directors, and, in case of the older one, at least half of the board of corporate auditors must be outside company auditors. Internal controls and risk management systems are also addressed in the FIEA and Corporate Governance Principles – applicable to listed companies only. The key requirement of FIEA is submission to FSA of an assessment report on the effectiveness of internal controls, and an audit of this assessment report. Apart from general regulatory pressure for compliance, FIEA also provides for sanctions for failure to comply, in the form of fines applicable to companies as well as individuals, also imprisonment applicable to individuals. These provisions of FIEA represent, at least potentially, an important strengthening of Japan's corporate governance structure. Their focus, however, is limited largely to material impacts on the accuracy of financial reports (although bribery is separately penalized under FIEA).

Recommendations

1) Consider formalizing internal audit as a profession (including company auditors in their internal audit role).
2) Strengthen corruption risk-mitigation provisions in the FIEA internal control requirement. Also, consider phasing in the same or similar internal control provisions for a wider range of public companies.

C. Integrity of financial statements

Japan has fairly rigorous standards in this area, partly as a result of reforms in the last decade. Accounting documents are to be retained for ten years, and the major forms of account manipulation are prohibited. All companies are required to prepare financial statements and to submit them to shareholders, regulators, and/or the public (in some cases, in summary form). IFRS are being integrated or converged piecemeal into Japanese reporting standards, and their voluntary use for consolidated financial statements is encouraged. Audits are not mandated for all companies. Companies with a board of directors, however, must have one or more company auditors and have her/them audit the financial statements. Moreover, large and/or listed companies must have their financial statements audited by external auditors, with the board required to approve the accounts and auditors to provide an opinion. Japan's audit standards incorporate ISA requirements including ISA 240 and 250. Internal reporting of illegalities discovered by the auditor is required, along with external reporting to FSA of material illegalities in FIEA audits. The materiality standard for the reports to FSA is to be interpreted based on the auditor's professional judgment, and it is not clear if facilitation payments or even some bribes would meet the standard of inclusion in such a report. The accounting and auditing profession is long established, and appears to be strictly governed. The CPA Act and JICPA apply fairly rigorous professional standards and safeguards for the independence of external auditors. Sanctions for violations of the rules by individuals, audit firms, and audited companies are potentially severe. Penalties for breach of auditor confidentiality are much more onerous than those for an auditor's failure to report illegalities to FSA as required.

Recommendations

1) Consider accelerating the mandatory application of designated IFRS, and including in the resulting standards a strengthened version of IAS 37 defining major corruption offenses as material for disclosure purposes.
2) Consider phasing in a broader requirement of external audit applicable to all public companies and others surpassing a size threshold.
3) Clarify the materiality requirement for auditor reports to FSA under the FIEA – to ensure that it includes at least major corruption offenses. Adjust the penalties applicable to auditor breaches of confidentiality and to auditor failure to report illegalities to FSA so that the sanctions are more in balance and less biased against reporting. Provide a safe harbor rule to protect auditors from liability for such reports to FSA.

Japan Legal, Regulatory, Policy Documents Referenced:

Certified Public Accountants Act (Act No. 103 of July 6, 1948), http://www.japaneselawtranslation.go.jp.

Companies Act (Act No. 86 of 2005), http://www.japaneselawtranslation.go.jp.

Financial Instruments and Exchange Act (Act No. 25 of 1948, amended by Act No. 32 of 2010), http://www.japaneselawtranslation.go.jp/.

Guidelines to Prevent Bribery of Foreign Public Officials, Ministry of Economy, Trade and Industry, 2004, http://www.meti.go.jp/english/information/downloadfiles/briberye2.pdf.

Principles of Corporate Governance for Listed Companies, Tokyo Stock Exchange, Inc., 2009.

Unfair Competition Prevention Law, No. 47/1993 (Amended 1994), http://www.oecd.org/daf/anti-bribery/anti-briberyconvention/2377955.pdf.

NOTES

[1] http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/japan/show-all.aspx.

[2] Toru Yoshikawa, “Corporate Governance in Japan: Flexible Adoption of Shareholder Oriented Practices,” in Asian Productivity Organization (2007), *Best Practices in Asian Corporate Governance*, pp.63-91: 63.

[3] http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/japan/show-all.aspx; government comments.

[4] Unfair Competition Prevention Law, No. 47/1993 (Amended 1994), art.10-bis(1), http://www.oecd.org/daf/anti-bribery/anti-briberyconvention/2377955.pdf.

[5] http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/japan/show-all.aspx; OECD (2011), *Phase 3 Report on Implementing the OECD Anti-Bribery Convention in Japan*, p.5; http://www.oecd.org/corruption/statement-of-oecd-on-japan-efforts-to-increase-foreign-bribery-enforcement.htm.

[6] http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/japan/show-all.aspx.

[7] Government questionnaire responses.

[8] Guidelines to Prevent Bribery of Foreign Public Officials, Ministry of Economy, Trade and Industry, 2004, http://www.meti.go.jp/english/information/downloadfiles/briberye2.pdf.

[9] Private sector questionnaire responses.

[10] http://www.meti.go.jp/english/policy/economy/corporate_accounting/index.html.

[11] Government questionnaire responses.

[12] The sources of all standards are provided in footnotes to the tables presented in the section of the Review entitled *International Standards for Country Reports.*

[13] *Audit Practice Standards for Internal Control Systems*, Japan Corporate Auditors Association, 2007. This is similar to the system described in the report on Korea, since the system in that country derives from it.

[14] http://www.iiajapan.com/.

[15] Questionnaire responses, government and accounting profession.

[16] Companies Act (Act No. 86 of 2005), http://www.japaneselawtranslation.go.jp.

[17] An outside (independent) director is defined in the Companies Act (art.2(15)) as follows. An "Outside Director" means a director of any stock company who is neither an executive director nor an executive officer, nor an employee, including a manager, of such stock company or any of its subsidiaries, and who has in the past served as neither an executive director nor an executive officer, nor as an employee, including a manager, of such stock company or any of its subsidiaries.

[18] Questionnaire responses from government and accounting profession.

[19] ADB/OECD Anti-Corruption Initiative for Asia and the Pacific (2011), *Recent steps taken to implement the ADB/OECD Anti-Corruption Action Plan and United Nations Convention against Corruption (UNCAC): Country Reports*, p.61. OECD (2011), *Phase 3 Report on Implementing the OECD Anti-Bribery Convention in Japan*, p.29-33.

[20] http://www.fsa.go.jp/en/policy/fiel/; http://www.deloitte.com/view/en_US/us/Services/additional-services/Japanese-Services-Group/Financial-Instruments-Exchange-Law-J-SOX/index.htm.
[21] Questionnaire responses from government and accounting profession.
[22] *Principles of Corporate Governance for Listed Companies*, Tokyo Stock Exchange, Inc., 2009.
[23] Questionnaire responses from government and accounting profession.
[24] http://www.ifrs.org/Use-around-the-world/Documents/Jurisdiction-profiles/Japan-IFRS-Profile.pdf; Action Plan Developed by The Japanese Institute of Certified Public Accountants (JICPA), p.40, http://www.ifac.org/sites/default/files/compliance-assessment/part_3/201206JapanJICPA_0.pdf.
[25] *Ordinance on Terminology, Forms and Preparation Methods of Consolidated Financial Statements, etc.* (Article 39-2); questionnaire responses by government, accounting profession.
[26] All currency conversions are at interbank rate as of Mar. 20, 2014, http://www.oanda.com/currency/converter/.
[27] Questionnaire responses: government.
[28] http://www.hp.jicpa.or.jp/english/accounting/system/index.html.
[29] *Standards of Assessment for Internal Control and Audit regarding Financial Reporting*, III.3 and III.4; questionnaire responses: government and accounting profession.
[30] JICPA Action Plan, p.13.
[31] Also included in *Standard to Address Risks of Fraud in Audit*, No. 17, 18; questionnaire responses: government.
[32] Certified Public Accountants Act (Act No. 103 of July 6, 1948), http://www.japaneselawtranslation.go.jp.
[33] OECD (2011: 29-33); JICPA Action Plan pp.3, 9-10; http://www.fsa.go.jp/cpaaob/english/overview.html.
[34] JICPA Action Plan, pp. 10, 25, 36.
[35] http://www.hp.jicpa.or.jp/english/accounting/independence/index.html.
[36] Companies Act art.329; JICPA Bylaw rules 11 to 28-2; questionnaire responses: government.
[37] http://www.hp.jicpa.or.jp/english/accounting/independence/index.html.
[38] Reporting period: April 1 to March 31 of following year.

Republic of Korea

1. Introduction

The Republic of Korea is a leader in the region across many dimensions, including its rapid economic development, its swift recovery from the 2008 global financial crisis, and its transition to democracy and governmental reforms. The steps Korea has taken to enhance transparency and deter corruption involving the private sector have been no less impressive, at least in formal terms. The country has adopted best-practice approaches in many areas of accounting, audit, and promoting integrity in business. Yet, assessments by organizations such as Transparency International and Bertelsmann suggest that Korean companies continue to be a significant source of bribery and influence-peddling both in Korea itself and abroad.[1]

Observers attribute the latter problem in large part to the predominant role of the *chaebol*, or family-controlled conglomerate network. This has been described as a complex cross-shareholding structure that could be horizontal (a circular network of companies with reciprocal partial ownership interests) or vertical (a pyramid in which holding companies, parent firms, and subsidiaries have reciprocal and overlapping partial interests). These structures are designed to keep *de facto* control of the corporate group in the hands of a minority group, generally the family of the founder. While the chaebol brings advantages in terms of coordination, discipline, and long-term strategy, it also encourages abuses from secrecy and opacity to overriding shareholder interests, fraud, and bribery. These results have been well-known since at least the Asian Financial Crisis of the 1990s, but have continued. Chaebols are cited as major obstacles to Korea's economic progress, especially given the power that controlling groups exert over regulation.[2]

These features of corporate governance make the kinds of safeguards discussed in this report of special importance – but also make it difficult to implement them successfully. In other words, chaebols raise in a more pointed way an issue that arises everywhere. Corporate governance systems are not self-correcting. They require effective intervention by persons outside the controlling groups, from independent directors and committees to activist shareholders, civic organizations, and government. The challenge, then, is to ensure that insider control is actually monitored and checked by actors of this kind that are free from the overriding influence of the controlling group. It is worth noting that Korea has in recent years adopted legislation on securities class actions – a potentially useful tool for protection of minority shareholders against insider abuse – and the first such case was approved to proceed in 2010.[3]

2. General efforts to prevent corruption involving the private sector

Korean business representatives report that there are legal provisions, public policies, and programs that promote cooperation between business and both law enforcement and regulators, and promote integrity in the private sector. For example, the Korean Transparent Society Network (formerly Policy Council for a Transparent Society) develops policies and facilitates cooperation among various sectors by sharing project plans and disseminating best practices. The Network brings together some 38 organizations in various sectors such as public service, business, and civil society. The Network supports legislative and regulatory amendments and institutional improvements necessary to ensure transparency. In its reporting under UNCAC, the Republic of Korea noted the difficulty of ensuring sufficient civil society participation in order effectively to raise anti-corruption awareness among the public. This suggested the need to strengthen the Network (formerly the Council) and increase its resources.[4] The activities of the Network will include joint integrity campaigns, training of anti-corruption trainers, exchange of information, research, and symposia.

Korea has taken steps to increase awareness of ethics standards and compliance procedures among firms, officials, and professionals involved in the private sector. For example, in 2011, Korea's Anti-Corruption and Civil Rights Commission (ACRC) organized training programs on ethical management and prevention of corruption for publicly-owned corporations and SMEs. ACRC has also produced *Business Ethics Brief*, a monthly newsletter on domestic and global trends in ethical business management, distributing it to corporate managers, civil society groups, and university students by e-mail (UNODC 2012: 14).[5]

There have also been focused awareness-raising and capacity-building efforts in regard to the IFRS and related standards. The ACRC, together with the Korean Institute of Certified Public Accountants (KICPA), has sought to enhance transparency in the private sector through educational measures. In 2011, the groups co-hosted a "Symposium for Transparent Accounting to Realize Fair Taxation" and a "Symposium to Evaluate Accounting Transparency in Private and Public Sector" (UN 2012: 5).

Further, Korea has endorsed certain public commitments by the business community in this area, e.g. to strengthen ethical management, enhance transparency in accounting, and improve corporate governance. For example, Korea introduced the Integrity Pact system by amending the Act on Contracts to Which the State is a Party in December 2012 and the Act on Contracts to Which the Local Government is a Party in August 2013, respectively. According to the amended Acts, a bidder or contracting party for a government contract will be required to sign an "integrity pact." The Pact stipulates that the bidder or contractor should not give or receive any money or entertainment when bidding for or making or implementing the contract. Violation of the Pact may result in the cancellation of the tendering or acceptance of the bid, or cancellation or termination of the contract.[6] These requirements have been incorporated into the due diligence measures of the Public Procurement Service (PPS). The integrity pact, citing the OECD Anti-Bribery Convention, commits bidders to establish codes of ethics and whistleblower protection mechanisms. The PPS also runs an Integrity Ombudsman Program, providing external monitoring of government contracting processes to ensure compliance with the PPS's integrity rules (OECD 2011: 37).[7]

International standard[8]	**Compliance by member country**
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	Several efforts underway.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) and 2): Act on External Audit of Stock Companies (art.15-3) provides protection for those who report unfair acts (which could include fraud and corruption), including mitigation of disciplinary action against them
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) Transparent Society Network (formerly Korean Policy Council for a Transparent Society): mixed, mainly civic network supporting policies in favor of transparency. 2) ACRC training programs on ethical management and prevention of corruption, *Business Ethics Brief*, newsletter on ethical business management. 3) Joint education initiatives with KICPA to enhance transparency in the private sector.
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	The Act on Contracts to Which the State is a Party and the Act on Contracts to Which the Local Government require bidders to sign an "Integrity Pact" in submitting bids. PPS Ombudsman program.

3. Internal Controls, Ethics, and Compliance

A. Internal audit

Korean law provides for audit[9] and internal control, but does not clearly distinguish the internal and external audit functions. General obligations apply to all auditors, and more specific rules come into play when external audits are performed. The Commercial Act (art.412) provides for the main general duties of an auditor, including oversight of company directors' performance of their duties. The auditor may investigate the affairs of the company, its subsidiaries, and the status of its property – but there is no explicit duty to detect or prevent illegalities.

Listed companies with total assets of 100 billion won (USD 94 million) or more are required to set up a structure and procedures for "internal accounting management," which appears to include aspects of internal audit, accounting, and internal control and compliance systems. The internal accounting management system must provide standards and processes for organizing, correcting, and reporting of accounting information; preservation of accounting records; and prevention of forgery, alteration, or destruction. An internal accounting manager must submit an annual report on the status of the system to the board of directors and the statutory auditor, who also evaluates and reports to the board annually. The statutory auditor's report may include opinions and recommendations for corrective action (Act on External Audit of Stock Companies, art.2-2; Commercial Act, arts.409-415-2).

This is one of several areas where the chaebol structure of governance intersects with transparency and oversight requirements. Use of that structure by controlling group or family members could override the internal accounting management system and related safeguards in two primary ways: evading the threshold-based requirement by keeping each of the related companies small enough, or undermining the safeguards by placing close allies in charge. A third factor, corruption in the form of bribery or cronyism, could either enable the above methods or make them unnecessary.

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	Internal accounting controls required of listed firms above size threshold (USD 94 million in assets), but internal and external audit not fully differentiated. Not fully sufficient to combat corruption.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect "illegal acts" in the books and records of companies, including bribery and other forms of corruption.	1) Internal and external audit functions not well differentiated. Internal audit and control functions shared by statutory auditor and internal accounting manager. 2) No such duty.
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	Per Act on External Audit and Commercial Act: 1) Listed companies with assets of USD 94 million or more required to establish internal accounting management systems. 2) and 3) Process: organize and correct accounts; preserve records; prevent forgery or alteration; assess internal control systems. 4) Internal accounting manager: annual report to board assessing internal accounts and controls.

B. Audit committee

Listed companies with total assets of more than two trillion won (USD 1.9 billion) are required to have audit committees, as are most financial services and investment companies. Other companies, including smaller firms and those exempted by presidential decree, may choose to have such a committee or not.[10] The comments on chaebol governance immediately above apply here as well – and the higher asset threshold would make the audit committee requirement less difficult to evade, should insiders determine to do so.

The audit committee must have at least three directors as members, and two-thirds must be outside directors. This intersects with the other pillar of chaebol governance – the ability to bring close allies into a company as "outside directors."[11] A truly independent audit committee can play a critical role in ensuring good governance and preventing corruption, which makes the process of appointing outside directors to the committee of central importance. In addition, financial and investment firms must have at least one accounting or finance expert as a member of the audit committee. The committee is responsible for ensuring oversight of accounting methods and internal controls, supervision of internal and external auditors, review of performance by directors and staff regarding internal controls and compliance, and guidance to company personnel on these matters. There are no explicit provisions on dealing with reports of corruption, though company directors have a duty to report to the committee any situation likely to cause the company a substantial loss, and both auditors and audit committees have a duty to report unfair acts to the statutory auditor.[12]

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	Per Commercial Act and Enforcement Decree, Financial Investment Services and Capital Markets Act: 1) Listed companies with assets over USD1.9 billion required to have audit committees, also most financial companies. 2) Committee members: at least 3 directors, of whom 2/3 are outside directors. Financial companies: at least one accounting/finance expert.
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers, employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	Duties of committee, per Commercial Act and Enforcement Decree, Financial Investment Services and Capital Markets Act: 1) Supervision of accounting methods, internal and external auditors; 2) Oversight of internal controls, review performance by directors and staff regarding internal controls and compliance; 3) Guidance to company personnel on internal controls. 4) and 5): Act on External Audit provides for both auditors' and audit committees' duty to report unfair acts.

C. Internal control and compliance systems

As mentioned, internal accounting management covers internal control systems as well as aspects of accounting and internal audit. This includes designating a compliance officer and setting up procedures for ensuring that accounting information is reliable. The Commercial Act provides rules for the appointment of the compliance officer, including qualifications and safeguards against conflicts of interest. The latter provisions (adopted in 2010, effective in 2012) aimed to establish "compliance guidelines" that ensure executives and employees comply with the law and manage their companies in accordance with good commercial practice (ADB/OECD 2011: 67, OECD 2011:28). The affected companies (listed companies above the USD 94 million asset threshold) must disclose the components of their internal control systems in a manner determined by Financial Services Commission regulations. External audits are to provide an opinion on the systems' quality and on company compliance (Enforcement Decree of Act on External Audit[13] art. 2-3).

According to government survey responses, management must present the internal control system in a document to be reviewed by executives and staff to understand their respective roles in the system. Management is tasked with setting expectations for ethical behavior in the company, providing the necessary training, taking appropriate disciplinary action, and system monitoring and revision. (These responsibilities are not stated in any policy or regulatory document that has been made available.) The Korean Ministry of Justice states that it has provided extensive awareness-raising to the business community with respect to these requirements.

Government questionnaire responses suggest that management must set up internal control activities such as review of management, physical control, analysis of outcome indicators, and segregation of duties. Regarding the use of third-party contractors, Korean Standard on Audit (KSA) 402 follows ISA 402 in providing guidance on due diligence, particularly for contractors that carry out transactions on behalf of the company rather than providing outsourced back office functions.

<table>
<tr><th>International standard</th><th>Compliance by member country</th></tr>
<tr><td>Procedural requirements:
1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation.
2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests.
3) Commitment and support across the company:
• Senior management to signal company-wide support for all components.
• Written undertakings and training on compliance required of all directors, officers, employees.
4) Risk-based approach:
• Individualized assessment of risks to the enterprise, including corruption risks.
• Regular monitoring and re-assessment of corruption risks.</td><td>Listed companies with assets of USD 94 million or more:
1) Disclose components of internal control systems per Financial Services Commission regulations and External Audit Enforcement Decree.
2) Internal accounting manager monitors control, accounting, internal audit systems. Procedures to ensure that accounting information is reliable. External audits to provide opinion on the systems' quality and on company compliance.
3) Management to present internal control system in a document to be reviewed by executives and staff; to set expectations for ethical behavior; to provide necessary training; take disciplinary action.
4) Management to ensure system monitoring and revision, appoint compliance officer. Internal accounting manager monitors control systems.</td></tr>
<tr><td>Substantive components:
1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements.
2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice.
3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations.
4) Require for third-party representatives, consultants, or</td><td>1) and 2): Internal control activities include review of management, physical control, segregation of duties, ensuring that accounting information is reliable.
3) No requirement.
4) Guidance on due diligence for third-party contractors, per ISA/KSA 402.</td></tr>
</table>

agents: • Written contract, adherence to company ethics standards and anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	
Enforcement, including sanctions for failure to comply.	No such provisions.

4. Integrity of Financial Statements

A. Accounting

1. Financial records

The form and retention of accounting records is addressed in Korea's Commercial Act (arts. 29 and 33). Books of account and balance sheets are to be prepared "in accordance with generally accepted fair and proper accounting practices." All businesses must preserve for at least ten years all trade books and important documents relating to the business, and these may be stored as microfilm or electronic files. Further, the original backup materials, referred to as "the slips or documents similar thereto," must be kept for at least five years.

International standard	Compliance by member country
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	All businesses to keep accounting records according to standards for 10 years, and backup documents for 5 years per Commercial Act.
Prohibitions (UNCAC 12(3), OECD Convention 8(1), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	1) and 2): Per Commercial Act, accountants or managers found to have forged, altered, damaged, or destroyed accounting records are subject to fines and imprisonment. 3) through 6): No explicit prohibitions.

2. Financial reporting requirements

Korea has adopted International Financial Reporting Standards (IFRS) as its national standards in this area, promulgating them as the Korean International Financial Reporting Standards (K-IFRS). The standards are monitored by the financial services and securities regulators under the Act on External Audit of Stock Companies (art.13) and the related Enforcement Decree (art.7.2). All listed companies, state-owned companies, and financial institutions (banks and financial holding companies, merchant banks and investment brokers, insurance firms, and credit card companies – whether listed or not) must prepare their financial statements and consolidated financial statements in accordance with K-IFRS (as of 2013).

The comments on chaebols in previous sections of the report apply here as well. Under Article 1-2 of the Act on External Audit, consolidated financial statements are prepared by a parent company in cases where a stock company and other companies have a "parent-subsidiary relationship," as prescribed by Article 1-3 of the Enforcement Decree. (A provision deleted from an earlier version of the Act required “conglomerates” to submit consolidated statements.) The impact of such a rule depends on transparency of beneficial ownership in the affiliated companies. IFRS 10 requires consolidated reporting based on *de facto* control rather than voting rights, but the question remains whether this requirement is applied in practice. Other businesses are permitted to use local accounting standards, which may not be IFRS-compliant. Instead of adopting the IFRS for SMEs, Korea updated its GAAP standards. Korean IFRS contain no modifications to the standard IFRS, apart from a few minor additions.[14]

International standard	Compliance by member country
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) Korean Exchange-listed, state-owned, and financial companies must comply with full IFRS. 2) IFRS for SMEs not adopted. SMEs may choose IFRS or Korean GAAP. 3) Disclosure required per IFRS 10.
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) Disclosure of material contingent liabilities required per IAS 37, but this would not normally require disclosure of future effects of corrupt transactions. 2) No explicit prohibition

B. Audit

1. Auditing requirements

Every listed company, and every stock company with assets over 10 billion won (USD 9.4 million) or debt in excess of 7 billion won (USD 6.6 million) must conduct an external audit. The comments made previously about chaebol structures are relevant here, but the threshold in this case is relatively low, and the requirement therefore relatively difficult to evade completely. The Korean Standards on Audit (KSA) adopted by KICPA are based on International Standards of Audit (ISA), which they closely follow.[15] State-owned companies under the Framework Act on the Management of Government-Financed Institutions are exempt from these audit requirements, as are other companies designated by Presidential Decree (Act on External Audit arts. 2, 7-2, 8; Commercial Act art. 449).

Complete audited financial statements and audit reports ("business reports") must be examined and "verified" by a representative officer of the company. The officer must certify that:

- No description or indication is false or incomplete with respect to material facts.
- No description or indication is seriously misleading any person who relies on it.
- The officer himself/herself has verified and examined the descriptions with due care.
- An internal accounting management system is operated in accordance with the Act on External Audit (for companies subject to audit under that Act).

The Best Practice Guideline for Internal Control over Financial Reporting (art.60) includes the standard that companies within the Act on External Audit should have their financial reports signed by the CEO.[16] Corporate officers and directors are subject to criminal penalties for providing false information or otherwise interfering with an audit (Act on External Audit, art.7; KSA 200.4-12).

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	Audit controls meet international standards. As to whether they are sufficient to prevent and detect corruption, this is unclear.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	1) Per External Audit and Commercial Acts: Listed companies, stock companies with assets over USD 9.4 million or debt in excess of USD 6.6 million must conduct external audits. 2) No information on special requirements for smaller firms.
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	ISA adopted as Korean standards, including KSA 240 and 250.
Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks. 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	1) Audited accounts to be verified by corporate officer. • No statement or information is materially false, incomplete or seriously misleading. • The officer has verified and examined statements with due care. • An internal accounting management system is operated in accordance with the Act on External Audit (for companies subject to audit under that Act). 2) Per Best Practice Guideline (large companies under Act on External Audit): CEO to sign financial reports. Per External Audit Act, KSA 200: Corporate officers and directors subject to criminal penalties for providing false information or otherwise interfering with an audit.

2. Auditor reporting of improprieties

Korea's policy in this area stays within the bounds of ISA 240 and 250. If an auditor discovers "any unfair act or any grave fact in violation of Acts and subordinate statutes or the articles of incorporation" having been committed by a director in connection with corporate business, he/she must inform the statutory (internal) auditor or the audit committee, include the fact in the audit report, and inform the general meeting of shareholders (Commercial Act, arts. 413, 447-4). The internal auditor also has a duty to report such a finding to the external auditor. Such improprieties or violations, along with internal control weaknesses that may have contributed to them, are to be discussed internally with management. The auditor's duty of confidentiality, however, prohibits the exposure of these facts to outsiders unless a specific enactment permits or requires it. If management's good faith is in doubt, the auditor should consult legal counsel (Act on External Audit art.10; KSA 240 and 250; Certified Public Accountants Act).

The OECD has addressed these issues in its Phase 3 Report on Korea (OECD 2011: 27-28). The Working Group had earlier recommended that Korea require the reporting of indications of bribery to the law enforcement authorities by external auditors or management committees. This situation had not changed by 2011 – external auditors were still obliged (and permitted) to report wrongdoing by a company director only to the statutory auditor, an audit committee and the general meeting of shareholders. The Board of Audit and Inspection Act (art.27) prohibits the disclosure of information or materials obtained in the course of an audit to another person. The Phase 3 Report concludes that reporting by auditors is overly constrained by confidentiality requirements in the law and a strict interpretation of the notion of "materiality," thus preventing critical evidence of corruption from emerging. The OECD recommends an amendment for this purpose to the Board of Audit and Inspection Act. Matters do not appear to have changed as of this writing.

The Government of Korea reports that, when an act of corruption causes financial damage to public organizations or involves the violation of the public interest (e.g. the environment, health, consumer interests and fair competition, or the Act on the Prevention of Bribery of Foreign Public Officials), anyone can report such an act to external authorities including the Anti-Corruption and Civil Rights Commission. A person making such report is afforded legal protection under anti-corruption and whistleblower legislation.[17] The protective measures under these acts include mitigation of culpability and exemption from the duty of confidentiality, according to the government's report. In summary, the auditor does not have a legal duty to report externally, but would be protected under the anti-corruption and whistleblower laws if she/he chose to do so.

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	Auditor to report serious improprieties and illegalities to audit committee (or statutory auditor), meeting of shareholders (Act on External Audit art.10).
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").	1) and 2): Reporting and materiality provisions conforming to ISA 240, 250: KSA 240 and 250. Auditor duty of confidentiality discourages her/his external reporting (Board of Audit and Inspection Act). But anti-corruption and whistleblower laws protect anyone making reports on these matters.

C. Professional standards and independence

Certified Public Accountants (CPAs) in Korea are bound by professional standards and codes of conduct. The Certified Public Accountants Act (arts.3-9, 41, 46) provides for mandatory registration, qualification, licensing, and continuing education. The Korean Institute of Certified Public Accountants (KICPA) is a member body of IFAC (International Federation of Accountants), and has fully adopted and published the IFAC-sponsored International Ethics Standards. Under Korea's Certified Public Accountant Act, CPAs must be members of KICPA and conform to its Code of Ethics. Under the CPA Act, KICPA is entrusted with professional governance functions such as registration and discipline of CPAs and accounting firms, setting audit standards, quality control of audited financial statements, and provision and supervision of continuing education for members. KICPA committees monitor and enforce the Code of Ethics and other professional standards, and investigate breaches of KICPA bylaws and provisions of the CPA Act. [18]

The Act on External Audit (art.3) provides that independent audits are to be performed by either an accounting firm as defined in the Certified Public Accountant Act or an audit team registered with KICPA. The individual auditors must be CPAs who have had further specialized training and experience in auditing (CPA Act arts. 23, 41). Monitoring, quality control, and discipline of auditors is provided under the CPA Act (arts 9.and 53), and the External Audit Act (art.15) and Enforcement Decree (art.8). The Securities and Futures Commission may supervise an auditor's work as it deems necessary.

The Act on External Audit (arts. 4, 4-2, 4-3) outlines the appointment procedure. The company must gain approval of the appointment from its statutory auditor or audit committee. Listed companies must get committee approval and appoint the auditor for a term of three consecutive fiscal years. As a further safeguard, the Securities and Futures Commission may designate the auditor in specific circumstances, including for firms in certain sectors or where audit problems have arisen in the past. Independent auditors, according to the Act (art.3) must be either accounting firms stipulated in Article 23 of the Certified Public Accountant Act, or audit teams registered in accordance with the Korean Institute of Certified Public Accountants.

Korea's safeguards against auditor conflict of interest appear fairly robust. The CPA Act (arts. 21, 33) and CPA Act Enforcement Decree (art.15-2) prohibit auditors from providing additional services to the audited firm such as preparation of financial statements and designing or operating its financial information system. The KICPA Code of Ethics (para.290.104-205) contains similar guidelines requiring auditors to avoid management roles, custody of assets, etc. Auditors of non-listed entities face lighter restrictions. Auditors (and close relations) and audit firms are prohibited from holding ownership interests in the entities that they are involved in auditing. Last, the audit cannot be conducted under the responsibility of a partner who has (or whose spouse has) been employed as a corporate officer of the client firm within the last year.

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) KICPA, per CPA Act, responsible for education, quality, registration, discipline of accountants. 2) KICPA and CPA Act: CPAs must conform to IFAC-based KICPA Code of Ethics.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	1) Appointment procedures and approvals (more stringent for listed firms) per Act on External Audit. 2) Restrictions on non-audit work per CPA Act and Decree, KICPA Code of Ethics. 3) No restriction. 4) Restrictions on auditor interests in client firms, former client officers as auditors (CPA Act and Decree, KICPA Code of Ethics). 5) One-year employment restriction on former employees
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) Registration, licensing, KICPA oversight per CPA Act. 2) KICPA dissemination of Ethics Code. 3) Supervision by KICPA, and by Securities and Futures Commission as needed (CPA Act, External Audit Act and Decree). 4) Professional discipline by KICPA.

D. Enforcement

Korean laws include substantial penalty provisions for violation of accounting standards. Where a CPA is found to have engaged in manipulation of accounts, trading in favors, or misuse of accounting company reserves, the CPA and members of an accounting firm involved in the violation are subject to imprisonment for up to five years and fines not exceeding 50 million won (USD 47,000). Accountants or managers found to have forged, altered, damaged, or destroyed accounting records are subject to imprisonment of up to five years and fines up to 30 million won (USD 28,000). Failing to prepare financial statements, preparing false financial statements, or concealing or falsifying information in the general meeting of shareholders may result in a prison term of up to three years or a fine not exceeding 30 million won (USD 28,000).[19]

The Financial Services Commission may impose suspensions against corporate officers, as well as fines against financial institutions and investment firms, in cases of failure to comply with accounting standards. The Securities and Futures Commission may recommend to the general meeting of shareholders of a company to dismiss a director, and may restrict issuance of securities during a specific period if such company fails to prepare financial statements according to accounting standards (External Audit Act art 16(2)).

In terms of audit, where a company official charged with financial reporting fails to submit financial statements to the auditor, refuses the auditor's request for data or inspections, provides false data or otherwise interferes with an external audit, this is subject to imprisonment of up to two years or a fine not exceeding 20 million won (USD 19,000). Similar penalties (imprisonment up to three years) are stipulated for failing to report "unjust" or illegal acts by directors to auditors or the audit committee, and for such omissions and false statements made to the general meeting of shareholders (Act on External Audit art.19, 20). An alternative enforcement method is for a shareholder[20] to file a legal action requesting a court to appoint an external inspector for the company (Commercial Act, art.467).

Sanctions apply to all firms that must meet audit standards under the Act on External Audit. The negligence provisions of the Act (arts.20-2, 21) apply penalties to company officials as well as the companies themselves. Where an employee or representative of a company, acting on company business, commits one of the violations described in the previous paragraph, the company itself is subject to the relevant fines. Also, fines up to 30 million won (USD 28,000) apply to managers or firms that fail to set up an internal accounting management system, to report on the internal accounting management system, or to state a full opinion on an audit report when required. As with the penalty provisions on accounting, the Financial Services Commission and the Securities and Futures Commission have authority to enforce the audit rules or refer cases to the courts.

Penalties are also provided for offenses by external auditors.[21] Thus, any auditor or audit committee member who accepts money or other favors in connection with the performance of her/his duties is subject to up to three years' imprisonment or a fine up to 30 million won (USD 28,000) or five times the economic benefit received, whichever is greater. Any auditor found to have forged, altered, damaged or destroyed key audit documents is subject to a maximum of five years' imprisonment and fines of 30 million won (USD 28,000).

Similar penalties (imprisonment limited to three years) are stated for auditor found to have failed to record required information or entered false statements in an audit report. The Financial Services Commission has authority to impose additional regulatory sanctions including suspensions and fines on financial institutions and investment firms failing to comply with audit rules.

International standard	**Compliance by member country**
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2): Sanctions are substantial, and include penalties for fraud and bribery. Whether they are used effectively against corruption is uncertain.
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Sanctions include: fines, suspension, de-licensing, imprisonment, de-authorize share issuance. 2) Penalties apply to companies (listed, state, and financial firms), managers, accountants. 3) Authority for enforcement: Financial Services Commission, Securities and Futures Commission, KICPA.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Sanctions include: fines, de-licensing, imprisonment, other regulatory sanctions. 2) Penalties apply to companies (firms above size threshold or listed), managers, auditors. 3) Authority for enforcement: Financial Services Commission, Securities and Futures Commission, KICPA.

5. Conclusion and Recommendations

As stated at the outset, Korea has well-developed rules and systems in this area. But the predominance of the chaebol model of corporate governance poses special challenges. There are a number of steps available to Korea for strengthening its safeguards against private sector corruption by way of financial reporting and controls.

A. General efforts to prevent corruption involving the private sector

Several public-private initiatives exist to enhance transparency in government and business, and the integrity pledge in the sensitive area of procurement is not only required but also monitored. The ACRC plays a positive role in disseminating information and training on governance and transparency in public and private sectors.

Recommendations

1) Provide official channels for companies to self-report corruption offenses, as well as incentives in the form of penalty mitigation for firms that report and/or take preventive steps.
2) Extend the use of integrity pledges beyond the procurement field to include a wider range of private sector abuses such as corporate fraud, business-to-business bribery, and failures in corporate governance. The Transparent Society Network could provide a forum for this, and following up the UN's earlier recommendation to strengthen the Network (formerly Council) would support this goal.

B. Internal Controls, Ethics, and Compliance

Korea follows best international practice in many of its provisions on internal audit, control, and accounting management systems. But this area is critical for corporate governance, and extra effort is needed to meet the special challenges here.

Recommendations

1) Consider more clearly differentiating the roles and requirements for internal and external auditors.
2) Clarify and publicize the criteria for selection of outside directors and accounting experts on corporate audit committees.

3) Provide explicit duties to prevent and detect corruption to the internal (statutory) auditor, audit committee, and internal accounting management system. This should include requiring the committee to provide a confidential channel of complaints about fraud and corruption. The internal control system should also be expected to make risk-based adjustments and to provide staff guidance on corruption-prone areas such as gifts.

C. Integrity of Financial Statements

Korea has adopted good international practice here as well, in the form of IFRS and ISA convergence. Again, given its particular corporate governance challenges, it can take further steps to improve its systems here.

Recommendation

1) As a high priority, require external auditor disclosure to public authorities of corruption or serious illegalities, at least in certain situations. A safe harbor clause should be adopted to cover all such reports. This issue has already been the subject of discussion between Korea and the OECD.

Korean Laws, Regulations, Policy Documents Referenced[22]:

Act on External Audit of Stock Companies, Act No.10303, 17. May, 2010.

Board of Audit and Inspection Act, 1963 (as amended).

Certified Public Accountant Act, 1997 (as amended).

Commercial Act, 1962 (as amended).

Enforcement Decree of the Act on External Audit of Stock Companies, Presidential Decree No.23496, 06. Jan, 2012.

Enforcement Decree of the Certified Public Accountant Act, 1997 (as amended).

Enforcement Decree of the Commercial Act, 1962 (as amended).

Financial Investment Services and Capital Markets Act, as amended by Act no. 10063, 2010.

Framework Act on the Management of Government-Financed Institutions

Korean Institute of Certified Public Accountants, Code of Ethics for Professional Accountants, 2006.

NOTES

[1] BTI (2012), BTI: South Korea Country Report, Bertelsmann Stiftung, http://www.bti-project.org/countryreports/aso/kor/; http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/republic-of-korea/snapshot.aspx.
[2] "Revamping Corporate Governance is the Key to Creative Economy," *Korea Herald*, Aug. 26, 2013, www.koreaherald.com; Solability (2013), "Corporate Sustainability Review Korea 2013," http://www.solability.com/pdfs/ESG%20Korea_2013.pdf.
[3] Hwa-Jin Kim (2012), "Corporate Governance in Korea: How to Improve Corporate Governance and Transparency," PPT presentation, Stanford University.
[4] UNODC (2012), *Implementation of article 12 of the United Nations Convention against Corruption, including the use of public-private partnerships*, CAC/COSP/WG.4/2012/2, p.14.
[5] Also: ADB/OECD Anti-Corruption Initiative (2012), "Recent steps taken to implement the ADB/OECD Anti-Corruption Action Plan and United Nations Convention against Corruption: Country Reports," p.67-8.
[6] http://pcrm.acrc.go.kr:9129/sys/DNAttach.php?id=5621.ef9a4e5a; government comments.
[7] OECD (2011), "Phase 3 Report on Implementing the OECD Anti-Bribery Convention in Korea," p.37.
[8] The sources of all standards are provided in footnotes to the tables presented in the section of the Review entitled *International Standards for Country Reports.*
[9] Listed companies with total assets of more than 10 billion won (USD 9.4 million) are subject to the requirement of external audit according to the Act on External Audit of Stock Companies, Act No.10303, 17 May, 2010, and its Enforcement Decree. See discussion below.
[10] Commercial Act, arts.409, 415-2, 542-11; Commercial Act Enforcement Decree, art.37; Financial Investment Services and Capital Markets Act, art.26.
[11] Kap Su Sol (2013), "Korea's chaebols are a corporate governance fiasco," www.businessinsider.com.au/corporate-sustainability-korea-a-review-of-the-solabiity-2103-survey-2013-2.
[12] Commercial Act, arts.409, 415-2, 542-11; Commercial Act Enforcement Decree, art.37; Financial Investment Services and Capital Markets Act, art.26; Act on External Audit of Stock Companies, art.10.
[13] Enforcement Decree of the Act on External Audit of Stock Companies, Presidential Decree No.23496, 06. Jan, 2012.
[14] http://www.ifrs.org/Use-around-the-world/Documents/Jurisdiction-profiles/Korea-South-IFRS-Profile.pdf.
[15] http://kicpa.or.kr/english/home/news/news02001.jsp.
[16] *Best Practice Guideline for Internal Control over Financial Reporting*, Operating Committee of Internal Control over Financial Reporting in Korea, government comments.
[17] Act on Anti-Corruption and the Establishment and Operation of the Anti-Corruption Act; the Act on the Protection of Public Interest Whistleblowers.
[18] http://kicpa.or.kr/english/home/info/info06001.jsp.

[19] Act on External Audit (arts.16 and 19-21); Certified Public Accountants Act (arts.48, 53-54); Financial Investment Services and Capital Markets Act (Parts VIII and X).

[20] With at least a 3% share in the company.

[21] Act on External Audit arts.16, 19-21; Certified Public Accountants Act arts.48, 53-54; Financial Investment Services and Capital Markets Act Parts VIII and X).

[22] http://www.moleg.go.kr/english/; http://elaw.klri.re.kr/eng_service/main.do.

Kyrgyz Republic

1. Introduction

Kyrgyzstan, a well-regarded reformer among ex-Soviet republics, has struggled in recent years to continue on this positive trajectory. The economy grew at about a 6% rate in 2011[1], with foreign investment reaching nearly 12% of GDP. But these are exceptions in the midst of several difficult years plagued by slow to negative growth, high inflation and unemployment, and political upheaval. Growth in the Kyrgyz Republic has been largely driven by gold and remittances, making the country vulnerable to shocks in the global economy. The country has a vigorous community of civic and political organizations that hold mass protests and continually pressed for democratic reform, especially since the regime change known as the “Tulip Revolution” of 2005. [2]

Corruption is a major issue in the country’s political arena. President Atambayev and his government in 2012 adopted a new State Anti-Corruption Strategy, aimed at improving supervision of anti-corruption policy implementation in Kyrgyzstan. In recent years, a Prosecutor General was dismissed on allegations of protecting a favored business from embezzlement charges, and in 2013, a former president and family members were sentenced to long prison terms for corruption and abuse of office. Corruption, however, remains endemic at all levels of society in Kyrgyzstan, according to an evaluation by the US Department of State. The law provides criminal penalties for official corruption, but officials continue to engage with impunity in corrupt practices such as the payment of bribes to avoid investigation or prosecution. Freedom House reports that the judiciary is not independent, while corruption is widespread among judges, who are underpaid.[3]

Corruption imposes major constraints on the private sector. In a recent World Economic Forum survey, companies ranked corruption as the most problematic factor for doing business in Kyrgyzstan after government instability. The US Department of State reports that foreign investors suffer from lack of knowledge about the complex Kyrgyz business environment, and try to facilitate market entry by forming joint ventures with local Kyrgyz partners. The same source reports that corruption related to taxes and tax audits is among companies’ most severe problems in conducting business. The World Bank Group’s 2013 *Doing Business* study found that companies spend an average of 210 hours making 51 tax payments a year and dealing with a total tax rate of 68.9% of profit. Another source (Enterprise Surveys) found that almost half of companies surveyed expect to make informal payments to get things done. The Kyrgyz legal and regulatory environment is still developing and remains highly bureaucratic, inconsistent and fraught with corruption, while the size of the informal economy has been estimated at around 50% of GDP. The government’s 2013-2017 economic development strategy, acknowledging the problems in the regulatory framework, aims at improving the legislative base for fair competition and simplifying procedures for opening and running new private enterprises.[4]

2. General efforts to prevent corruption involving the private sector

In 2012, President Atambayev launched a new Anti-Corruption Strategy including guidance for the executive, legislative, and judicial bodies on developing and implementing specific action plans. In the same year, the government adopted a medium-term Anti-Corruption Program (2012–2014) centering around three priorities: (i) eliminating corruption schemes in the public sector, (ii) reforming incentives in the public sector to prevent corruption, and (iii) partnering with civil society on anti-corruption activities. BTI reports that, by the end of 2012, it was possible to notice a somewhat greater awareness and concern about corruption in the public service. The newly established Anti-Corruption Service (within the State Committee for National Security), despite having a poorly defined legal mandate and jurisdiction, was turning into a feared agency. These steps, while positive, have not yet brought significant reductions in the rampant corruption that is reported to pervade the country.[5]

Civic organizations have relatively wide freedom to conduct their activities in Kyrgyzstan, and public authorities are more willing than in the past to cooperate with civil society in the area of anti-corruption policy (though this is still irregular). Business associations such as the Bishkek Business Club have worked to promote the anti-corruption agenda for companies in the Kyrgyz Republic. The club brings together business leaders in Bishkek in order to improve the conditions for companies and strengthen entrepreneurship. Among other things, they have done work on the tax system in Kyrgyzstan. The International Business Council-Kyrgyzstan also promotes principles of anti-corruption, along with human rights and environmental protection.[6]

The Kyrgyz Republic has joined the Extractive Industries Transparency Initiative (EITI), an international strategic alliance between governments, private companies, civil society groups, and international organizations aimed at publicizing and accounting for revenue flows in the oil, mining and other extractive resource industries. Kyrgyzstan has substantial reserves of coal, gold, and uranium, with gold being its main export. Implementation of EITI criteria towards full compliance started in 2004, but stalled in later years. In 2011, Kyrgyzstan was finally granted status as fully compliant with the EITI principles. Also, an Energy Sector Transparency Initiative adopted through presidential decree has led to the establishment of a Supervisory Council (with public representation) at the Ministry of Energy to oversee the management and reporting of energy sector accounts.[7]

International standard[8]	Compliance by member country
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	Several initiatives underway by government and by private and civic sectors, as well as joint programs.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) Kyrgyzstan has a primary anti-corruption agency as well as other institutions – executive, parliamentary, and free-standing – dealing with this area. Some of these provide reporting channels. 2) No provision on sentence-mitigation.
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) EITI and Kyryz Energy Sector initiative provide oversight of extractive sectors. 2) Business associations address corruption, though the extent to which they focus on business ethics is unclear. Public sector does not appear to be much involved. 3) Kyrgyzstan does not have an official corporate governance code (see below).
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	These do not appear to be widely used, although Kyrgyzstan is certified as fully compliant with EITI, an international mechanism similar to integrity pacts.

3. Internal controls

The laws of Kyrgyzstan dealing with corporate governance contain very little on internal control mechanisms, apart from audit committees. Other countries often address these matters in a code of corporate governance, but the Kyrgyz Republic has no official or widely-accepted code of this kind.[9] The country, though small, has three stock exchanges and some 600 listed companies – a fact that could be expected to pose the need for corporate governance rules. Nor do corporations adopt individual governance codes for internal guidance. An IFC survey a few years ago found that, of 63 companies surveyed, only three had a single code or document providing such guidelines, and a large majority of firms saw no need for such a document.[10]

A. Internal audit

The above-mentioned survey (IFC 2010: 14) found there to be a "lack of understanding of the nature of internal audit." Nearly half of the companies did not have an internal audit function, while one-third reported that they had established an internal audit service, and the remainder were confused about the concept. Internal audit was in some cases mistaken for a different function or seen as a controlling and advisory body. Internal audit is not mentioned in the company, accounting, or audit laws.

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	Not sufficient – no legal provision for internal audit, no consistent practice or understanding of internal audit.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect "illegal acts" in the books and records of companies, including bribery and other forms of corruption.	1) and 2): No provision.
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	1) through 4): No legal provision, but some of these responsibilities may be assigned to other corporate officers or organs (see below).

B. Audit committee

The Law on Joint Stock Companies[11] (JSC Law, art. 62) requires companies to establish an audit committee. Its purpose is “control over the financial and economic activity of the Company by the general meeting of shareholders,” and members are elected (unless otherwise provided in the charter). The committee must have defined area of competence, a program of activity, and a procedure for convening its meetings. It duties include overseeing annual audits of financial results and ordering special audits on the initiative of the committee, the board, the AGM, or the holders of 10% of voting shares. The audit committee must meet at least quarterly and communicate its activities to the shareholders. The committee can demand documents from management on the business and finances of the company. The audit committee may also call extraordinary shareholder meetings, bring in independent experts, make recommendations about the choice and retention of the external auditor, and seek explanations from the auditor. Members of the committee cannot simultaneously sit on the board, hold a management position, or be employees of the company. Banking law further specifies that audit committees of banks must have three non-executive members of the board.[12]

These rules appear not to be followed consistently. The IFC survey mentioned above (IFC 2010: 12), found that only two of over 60 companies surveyed had set up any committees, and only one of these had an audit committee. The wording of the JSC Law seems to allow for the possibility that an audit committee for a non-financial company might be a single person (“auditor”). Some of the surveyed companies may have appointed individuals for this function, or indeed may not have addressed the matter at all.

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	1) JSC Law requires an audit committee (or an individual to perform this function). 2) Banks must have audit committees with 3 independent (non-executive) directors.
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers. employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	1) JSC Law requires audit committee to have terms of reference, including oversight of audit. 2) Per JSC Law, audit committee has powers to compel information and order special meetings and audits. Internal control and ethics may be covered but no explicit mention. 3) through 5: no provision.

C. Internal control and compliance systems

As mentioned, internal control and compliance are given very little attention in the laws relevant to corporate governance, nor is there an official or widely-accepted voluntary code dealing with this area.

In the Law on Accounting[13] (art.7), however, company management is made responsible for internal accounting, reporting and control systems, and procedures for supervising business transactions. Beyond this mention, those matters are not spelled out.

Further, the anti-corruption legislation contains certain provisions that must be taken into account by private sector firms. Gifts to state officials and between enterprises (above a *de minimis* level of about USD 20) are prohibited – although the giving (active) side of the government gift transaction is not explicitly outlawed. Any gift passing between businesses (including securities and services) is outlawed if directed to a person with managerial functions and for the purpose of encouraging that person to use managerial authority by acting in the interest of the giver.[14] These provisions do not suggest *how* a company is to ensure that its personnel do not engage in such activities, i.e. what the internal controls should be.

International standard	Compliance by member country
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees. 4) Risk-based approach: • Individualized assessment of risks to the enterprise, including corruption risks. • Regular monitoring and re-assessment of corruption risks.	1) No provision. 2) Law on Accounting states management responsibility for internal control. In practice, little use of internal governance codes. 3) and 4): No provision.
Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements. 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations. 4) Require for third-party representatives, consultants, or	1) through 4): No provision. Corruption law covers gifts, but not internal controls dealing with them.

agents: • Written contract, adherence to company ethics standards and anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	
Enforcement, including sanctions for failure to comply.	No provision.

4. Integrity of financial statements

A. Accounting

1. Financial records

The Law on Accounting (arts.15-16) requires businesses to keep “source accounting documents, accounting registers, the working chart of accounts, financial statements and other accounting policy related documents” in electronic form and hard copy. Management is responsible for organizing and storing these records. Retention periods and penalties for failure to comply are not given but are said to be stated in other legislation, including the Code of Administrative Responsibility and the Criminal Code. The Tax Code[15] (art.23) requires the retention of records, books, and accounts for three years in the case of individuals and six years for companies and other organizations.

International standard	Compliance by member country
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	Individual entrepreneurs to keep records for 3 years, companies to keep records in defined format (electronic and paper) for 6 years.
Prohibitions (UNCAC 12(3), OECD Convention 8(1)), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	1) IFRS and Law on Audit prohibit use of false records (see below). 2) Retention period in Tax Code refers to sanctions for failure to keep records but does not add penalties for intentional destruction. 3) through 6): Addressed in general accounting standards (see below), but no explicit prohibition.

2. Financial reporting requirements

The JSC Law (art.79) requires companies to perform accounting and financial reporting in accordance with the Law on Accounting. Companies are to produce annual reports for preliminary board approval and review by the AGM. The Law on Accounting (art. 14) further requires all businesses to publish their financial statements within 90 days of the end of their fiscal year. As for the manner of publication, the requirement is not specific and merely refers to "publishing according to the legislation" (World Bank 2008:3).

The Law on Accounting (art.1) identifies the framework for financial reporting as IFRS for all "public interest entities," including listed companies, financial institutions, and investment funds. For all others (apart from state exceptions), the required standards are IFRS for SMEs. Small businesses (as defined in other legislation) may use IFRS for SMEs or the simplified rules established by the Kyrgyz government. Special accounting and financial reporting standards for Islamic financial institutions are available for the relevant entities (stipulated in separate legislation).

Company management is responsible (on pain of administrative and criminal sanctions stated in other legislation) for preparing financial statements according to the standards. This requirement includes preparation of consolidated statements where required by IFRS or IFRS for SMEs (arts.10, 16). Although the legislation indicates that responsibility for financial reporting is with the CEO and does not specifically require that financial statements should be signed by a company's chief accountant, in practice financial statements are signed by both the CEO and the chief accountant (World Bank 2008: 3). An authorized state body is to be made responsible for instituting the above standards and monitoring their application, and for collaborating with the accounting profession on standards development and training (art.6). The main state authority responsible for regulation of accounting and financial reporting is the Service for Regulation and Supervision of the Financial Market of the Kyrgyz Republic (SRSFM)(World Bank 2008:5).

The question arises as to whether Kyrgyz businesses are fully IFRS-compliant, or should be. In the survey conducted by the IFC (2010: 13), about three-quarters of companies stated that they had already switched to preparing financial statements in accordance with IFRS. On the other hand, there are no specific financial reporting requirements for the many SOEs, and no centralized monitoring of financial information of these enterprises by the government. Under the tiered system of the Law on Accounting, individual entrepreneurs are required to prepare only a statement of revenues and expenses. SMEs must produce financial statements in accordance with IFRS for SMEs, which is reported to place an undue burden on many of them. Few SMEs are incorporated as JSCs, and external demand for their financial information is often limited to the tax authorities. A 2001 decree provided for gradual implementation of IFRS, but without a process for official adoption of new and updated IFRS. Further, the Law specifies that entries must be made on the basis of source documents for specific transactions. But IFRS often requires recognition and measurement on a basis other than actual transactions where there are no externally generated primary source documents (e.g. valuation adjustments for doubtful debts). These last two points suggest that even businesses that use IFRS as required by law may not be fully compliant (World Bank 2008: i, 5, 8).

International standard	Compliance by member country
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) All entities to produce financial statements. Public interest entities must use IFRS 2) Other firms to use IFRS for SMEs, except small and individual enterprises, which use a simplified format. 3) No express requirement, but public interest entities to use IFRS.
4) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 5) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) Material contingent liabilities covered by IAS 37 for entities using IFRS and IFRS for SMEs. This would not normally require disclosure of potential liability for corrupt acts. 2) No explicit prohibition.

B. Audit

1. Auditing requirements

The Kyrgyz Republic's Law on Auditing[16] sets the basic requirements for company audits. Annual audits are required for licensed financial institutions, insurance companies, public companies (having made public offerings of securities), investment and private pension funds. The audit is to be done by an independent professional, based on a signed agreement, for the purpose of determining whether the company's financial statements meet the requirements of the law (art.3).[17] Companies are required to assist the auditor in the timely completion of the audit and respond to the auditor's requests for documentation and explanations. The final audited financial statements must be made available to the shareholders and published in the mass media. The company is to notify the state oversight body (SSRFM) of having completed all components of the statutory audit.

Additional requirements apply to financial institutions. Banks are required under the Auditing Law (art. 1-1) to perform audits in accordance with international auditing standards and the requirements of the Banking Law. Banks must (within 10 days of receipt) send copies of the audit opinion and audit report to the Bank of Kyrgyzstan, together with the financial statements and any further documents required. Auditing standards are established by the Government of the Kyrgyz Republic (art.2).

As in the case of accounting, auditing is to be governed by an authorized state agency that develops audit standards, oversees the training and quality of the profession, and monitors the compliance of professionals with audit standards (Audit Law, art.8). In a 2002 resolution, the Kyrgyz government adopted the ISA as the country's national auditing standards. However, according to the World Bank (2008: 10), there are significant delays in the process of translating and incorporating changes in ISA into the Kyrgyz regulatory framework. As a result, the international standards in force are not up to date – for example, 2001 standards were in force in 2008. In addition, the audit requirements are not always followed in practice. The survey of corporate governance practices by the IFC (2010: 14), found that about three-quarters of joint stock companies surveyed undergo external audits.

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	Controls are not clearly sufficient. Limited scope of application, lack of explicit focus on corruption, and uneven compliance weaken controls.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	1) and 2): Publicly listed companies and companies involved in financial and investment services must perform annual audits.
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	ISA have been adopted as national audit standards, including ISA 240 and 250, though the version in force is out of date.
Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks.	1) Audit opinion to state whether financial statements are accurate and meet legal requirements. Internal controls are not mentioned. 2) No legal requirement of signature by CEO and chief accountant, though this is reported to be done commonly in practice. Company officials must assist the auditor and comply with requests for documents and explanations.

2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	

2. Auditor reporting of improprieties

Apart from the ISA provisions on possible reporting of irregularities to company officials and external authorities, there is no legal basis provided for such reporting in Kyrgyzstan. It is neither required nor protected. In fact, the Law on Auditing (art.7) emphasizes confidentiality for the information and documents obtained by the auditor in the course of an audit, and prescribes sanctions for violations. This provision does, however, allow disclosure to the authorized audit supervision body established by the state.

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	Internal reporting advised by ISA 240 and 250.
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith (“safe harbor”).	1) ISA 240 and 250 support possible reporting, but only if legally required and permitted. 2) No legal basis, either a requirement or a safe harbor. Audit Law stresses confidentiality.

C. Professional standards and independence

The Law on Accounting (art.6) outlines the regulatory framework for accountancy. The authorized state oversight body – separately established as SRSFM – provides “general methodological guidance” on accounting and is responsible for implementing “a uniform state policy” in this area. This includes development of IFRS-compliant curricula on accounting and financial reporting, coordinating the activity of other official agencies regulating activities related to accounting, and working with professional bodies to strengthen accounting in Kyrgyzstan. The legislation further states: "Professional activities in the field of accounting and financial statements are not subject to licensing and certification by the public authorities of the Republic."

Thus, the accounting profession is not formally recognized in Kyrgyz legislation and no requirements or criteria have been established for the certification and competence of professional accountants (World Bank 2008: 11). The Union of Accountants and Auditors (UAA) oversees professional conduct, but does not set technical or educational standards, which are handled by government agencies. UUA adopted the IESBA Code of Ethics in 2008, and takes responsibility for sharing information and providing training on the Code, which has not been adopted or enforced by a state body.[18]

In the case of auditing, the situation is different. The Law on Auditing (art.1) brings the profession under state regulations and licensing requirements. To qualify as an auditor, a person must pass the examination and have completed a degree in a relevant field with three years' experience (related to business), or have completed a different degree with seven years' experience (art.9). Auditors and audit firms are not permitted to engage in businesses other than the following: auditing, audit-related and financial reporting services, financial and economic analysis, and consulting or training in areas related to accounting, finance, tax, and management (art.1). An audit practitioner may not work in the public service (art.4).

Auditors are generally appointed by the company board and confirmed by the AGM. There are no specific rules dealing with termination of an audit assignment except in the case of banks, which must inform the National Bank (World Bank 2008: 10-11). The Law on Auditing spells out several safeguards against conflicts of interest. Independent audits may not be carried out by anyone involved in the audited company such as a shareholder or employee (or close relation of such person) or one who is providing non-audit services to the company (or has done so within the last two years) (art.11). Similarly, audit firms are barred where their partners have shares or other property interests in the audited company (or affiliates), and where company (or affiliate) founders or (significant) owners have shares or property interests in the audit firm. Audit contracts may not make payment dependent on pre-determined conclusions. Failure to comply with this regulation and other professional rules (see below) can result in revocation of the professional audit license (art. 10).

The Audit Law (art.8) places auditing under the authority of a government agency – again, SRSFM has been established for this purpose. The agency proposes audit standards for government approval, issues norms for certification and training of auditors, licenses professional auditors, monitors compliance with standards, provides a mechanism for submission of audited financial statements for agency review, and maintains a register of licensed professionals and organizations. The law does not require membership in a professional organization, and these organizations – notably UUA – are not involved in certification or standard-setting, and do not exercise disciplinary authority. There is reported to be no systematic audit quality control as such.[19]

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) Per the Accounting Law, the profession is not subject to official licensing. 2) UUA adopted the IESBA Ethics Code.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	1) Audit Law does not provide for appointment or termination procedures. 2) Audit Law restricts non-audit work of auditors. 3) No provision. 4) Audit Law restricts both auditor/audit firm interests in client company and vice-versa. 5) No restriction.
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) Audit Law provides for professional certification by SRSFM. 2) Audit Law authorizes SRSFM to set training standards, but does not apply or require an ethics code. UUA has an ethics code (IESBA) for accountants. 3) SRSFM, a government body, regulates auditors but does not exercise systematic quality control. 4) Rule violations may result in revocation of license.

D. Enforcement

According to a 2008 World Bank report (World Bank 2008: 15-16), there was no effective enforcement of financial reporting standards apart from that exercised in the supervision of banking institutions. Similarly, quality control and enforcement of auditing standards were largely absent. As a result, the World Bank's analysis showed that the quality of financial statements prepared by the majority of enterprises fell far short of the standard implied by the reporting requirements embodied in the statutory framework.

While accounting and audit standards are not well enforced, sanctions are provided for non-compliance with basic legal norms. Thus, the Law on Auditing (art.6) prescribes the removal of the auditor and revocation the audit license of the auditor and audit firm, as well as potential civil and criminal liability (spelled out in separate legislation) for knowingly presenting or signing a false audit opinion. The Law also provides for the revocation of the audit license in the following cases (art.10):

- the use of forged documents in an application for auditor certification;
- systematic violation of (i.e. two or more times) of audit standards or relevant laws in the course of an audit;
- knowingly signing a false audit opinion; and
- failure to comply with provisions of the Law on Auditing (arts.7, 10) on audit restrictions (conflict of interest safeguards) and duty of confidentiality.

Other available sanctions are not stated in the laws on accounting, audit, or corporate governance. Those laws refer to penalties contained in separate civil, criminal, and administrative codes.

International standard	Compliance by member country
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2): The rules are not stringent and are apparently not well enforced, and so are not effectively used to combat corruption.
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) through 3): Accounting professionals are not regulated as such. Penalties applicable to officials and companies are cited in separate legislation.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) through 3): Audit professionals are subject to revocation of license for a range of violations. Penalties applicable to officials and companies are cited in separate legislation.

5. Conclusion and recommendations

A. General efforts to prevent corruption involving the private sector

Civil society and business associations in Kyrgyzstan are relatively free and have been active in pursuing anti-corruption goals in the public and private sectors. Government, for its part, has taken the initiative in amending the anti-corruption laws, issuing a new strategy, and setting up a new Anti-Corruption Service. However, these state initiatives appear to involve little real partnership with the citizens or the private sector. The Anti-Corruption Service draws strength from its placement under the executive national security arm, but this does not make it accessible to the public and may have the opposite effect. Kyrgyz participation in the EITI is a positive development, though the use of domestic integrity pacts for self-policing of anti-corruption norms in the business sector could well be more widely used.

Recommendations

1) Incorporate greater public outreach and channels for public communication and complaint into state anti-corruption authorities.
2) Adopt legislative provisions on sentence-mitigation and other incentives for persons involved in corruption to self-report.
3) Launch a joint public-private initiative to develop a corporate governance code.
4) Encourage wider use of integrity pacts in the private sector, both within and beyond the extractive industries.

B. Internal controls

Overall, internal control and compliance systems are under-developed and under-utilized in Kyrgyzstan. There is as yet no official or widely-accepted corporate governance code, no legal provisions related to internal audit, and very little guidance on internal controls. There are legislative provisions on audit committees that appear reasonably defined, especially for banks. In practice, not only is there little or no attention paid to internal governance codes, internal audit, or control systems, but it appears that most companies have not established audit committees (although it is possible that they have individuals fulfilling this function).

Recommendations

1) Develop a corporate governance code, as mentioned above, and support dissemination and training in its application within companies. Include in the code provisions on internal controls, especially ethics and risk management standards, and control systems. Phase in the code as a mandatory set of rules for public companies, SOEs, and other public-interest entities.
2) Amend the law to expand the required 3-person audit committee beyond the financial sector to other public companies, SOEs, and other public-interest entities.
3) Support the development of an internal audit profession and governance framework, and phase in a requirement of having a formal internal audit function in all public companies, SOEs, and other public-interest entities.

C. Integrity of financial statements

Record-keeping is required by company legislation, but retention periods (3 and 6 years) are spelled out in the tax code. Prohibitions on off-the-books deals and other manipulations that may hide corruption are not addressed. The Kyrgyz Republic has adopted IFRS and ISA, although it is reported that the versions in force lag several years behind the current ones. The law does not provide for auditor reporting of irregularities including corruption to state authorities. Auditing is regulated by the state, but accounting is not, and in both cases professional organizations provide support and professional development but not discipline. As for enforcement, research from a few years ago suggests that it is ineffective and that financial statements – audited or not – are generally of poor quality.

Recommendations

1) On record-keeping, consider raising the retention period for JSCs to 7 years, and adopt explicit prohibitions of off-the-books accounts and other methods that may be used to disguise corruption.
2) Adopt and launch a plan for improving the timeliness of IFRS and ISA updates, perhaps in coordination with other countries using Russian-language standards.
3) Adopt a requirement for auditors to report serious irregularities, including corruption, to state authorities. Accompany this with a safe harbor provision protecting such auditors from liability.
4) Support the development of a formal accounting and financial reporting profession with a governing body having capacity-building, supervision, and disciplinary capabilities.

5) Clarify sanctions for auditing and financial reporting offenses – for both individuals and companies – and strengthen enforcement. Develop a much more rigorous and systematic quality control system within SRSFM (or elsewhere).

Kyrgyz Republic Laws, Regulations, Policy Documents Referenced:

Law of the Kyrgyz Republic On Accounting, No.76/2002 (as amended), http://www.nbkr.kg/index1.jsp?item=52&lang=ENG

Law of the Kyrgyz Republic On Auditing Activities, No.134/2002 (as amended), http://www.nbkr.kg/index1.jsp?item=55&lang=ENG

Law of the Kyrgyz Republic On Joint Stock Companies, No.64/2003 (as amended), http://www.nbkr.kg/index1.jsp?item=47&lang=ENG

Tax Code of the Kyrgyz Republic , No.25/1996 (as amended), http://www.libertas-institut.com/de/Mittel-Osteuropa/Tax%20Code.pdf

NOTES

[1] Atlas method, http://data.worldbank.org/indicator/NY.GNP.PCAP.CD.

[2] http://www.business-anti-corruption.com/country-profiles/europe-central-asia/kyrgyzstan/show-all.aspx; BTI (2014),*Kyrgyzstan Country Report*, Bertelsmann Stiftung, http://www.bti-project.org/reports/country-reports/pse/kgz/index.nc; World Bank Group (2013), Kyrgyz Republic Partnership Program Snapshot 2013, p.11, http://www.worldbank.org/content/dam/Worldbank/document/Kyrgyzrepublic-Snapshot.pdf.

[3] http://www.business-anti-corruption.com/country-profiles/europe-central-asia/kyrgyzstan/show-all.aspx; BTI (2014).

[4] BTI (2014); http://www.business-anti-corruption.com/country-profiles/europe-central-asia/kyrgyzstan/show-all.aspx.

[5] BTI (2014); http://www.business-anti-corruption.com/country-profiles/europe-central-asia/kyrgyzstan/show-all.aspx.

[6] http://www.business-anti-corruption.com/country-profiles/europe-central-asia/kyrgyzstan/show-all.aspx; World Bank (2013: 3).

[7] http://www.business-anti-corruption.com/country-profiles/europe-central-asia/kyrgyzstan/show-all.aspx; World Bank (2013: 3).

[8] The sources of all standards are provided in footnotes to the tables presented in the section of the Review entitled *International Standards for Country Reports.*

[9] OECD (2013), Corporate Governance: Capital Markets in Eurasia – Two Decades of Reform, books.google.com/books?isbn=9264203974.

[10] IFC (2010), *Survey of Corporate Governance Practice in the Kyrgyz Republic*, pp. 6, 10.

[11] Law of the Kyrgyz Republic On Joint Stock Companies No.64/2003 (as amended), http://www.nbkr.kg/index1.jsp?item=47&lang=ENG.

[12] World Bank (2008), Report on the Observance of Standards and Codes (ROSC): The Kyrgyz Republic – Accounting and Auditing, http://www.worldbank.org/ifa/KyrgyzROSCFinal.pdf.
[13] Law of the Kyrgyz Republic on Accounting, No.76/2002 (as amended), http://www.nbkr.kg/printver.jsp?item=52&lang=ENG.
[14] http://www.k-a.kg/eng/faq/5-frequently-asked-questions-anti-corruption-laws-kyrgyz-republic#t43n1199.
[15] Tax Code of the Kyrgyz Republic , No.25/1996 (AS AMENDED), http://www.libertas-institut.com/de/Mittel-Osteuropa/Tax%20Code.pdf.
[16] The Law of the Kyrgyz Republic On Auditing Activities, No.134/2002 (as amended), http://www.nbkr.kg/index1.jsp?item=55&lang=ENG.
[17] Also, JSC Law, art.63.
[18] Action Plan Developed by the Union of Accountants and Auditors, Kyrgyzstan, pp.5, 8, http://www.ifac.org/sites/default/files/compliance-assessment/part_3/201307%20Kyrgyzstan%20UAA.pdf.
[19] World Bank (2008: 12-16); UUA Action Plan, pp.3-5, http://www.ifac.org/sites/default/files/compliance-assessment/part_3/201307%20Kyrgyzstan%20UAA.pdf.

Macao, China

1. Introduction

Macao, China's situation is special in many ways. Since 1999, it has operated under the principle of "One Country, Two Systems" embodied in the Basic Law of the Macao Special Administrative Region (SAR) of the People's Republic of China. The Macao SAR has its own legal and judicial systems with the power of final adjudication. Under its laws, corruption has a broad definition which covers both the offering and acceptance of bribes, as well as bribery between private sector entities.[1]

The dominant role of the gambling industry and the financial sector, and the importance of foreign investment and offshoring, makes the prevention of corruption involving the private sector a high priority. The rapid growth of the gambling industry, and the government's reliance on it as a source of over 80% of state revenues[2] (prompting efforts to diversify the economy), poses risks of fraud and corruption. Commentators have noted the high consulting fees paid by foreign companies for the opportunity to invest in the sector, along with the money laundering risks posed by large casino betting (and cashing-in).[3] Macao, China is a member of the Asia/Pacific Group on Money Laundering (APG), in which context a "National money laundering and terrorist financing risk assessment" is being conducted.[4]

While Macao, China's laws in these areas have had to develop in order to keep pace with the growth and complexity of investments in the SAR, there is no stock exchange. Thus, financial reporting, audit, and other mechanisms are not driven, as elsewhere, by the needs of a formal domestic market in equities. However, the size of companies, especially in the gambling sector, and the particular corruption risks posed by the predominance of the sector and the regional context, would seem to justify stringent corporate governance and transparency requirements even in the absence of a domestic exchange.[5]

2. General efforts to prevent corruption involving the private sector

Macao, China's Commission Against Corruption (CCAC) plays an active role in the prevention of corruption involving the private sector. This approach is required by the Law on Prevention and Suppression of Bribery in the Private Sector Law (Law no. 19/2009). The Law applies the relevant Penal Code provisions on corruption to the private sector, and empowers the CCAC to prevent and suppress them. Essentially, the Law considers corruption by private sector individuals, including active and passive bribery, as a violation of fiduciary duty to the employer or enterprise – and treats inter-firm bribery as a crime. Prohibitions on civil service corruption are addressed separately in the Penal Code.

CCAC has a 24-hour hotline and receives reports and requests for help through its main office and two branches. In 2012, the branches received 81 complaints and reports, 35 requests for help and 692 enquiries.[6] Under Law no. 19/2009, complaints of corruption in the private sector must be filed by a person with a legally protected interest. This may be an employer or principal, or a firm suffering from unfair competition due to bribery.

In addition, the CCAC is authorized by its statute[7] to waive prosecution for corruption offenses “where the offender helps effectively in the search for evidence which may be decisive in establishing the elements of the crime” – especially in identifying offenders. As an investigative tactic, the CCAC may approve acts of bribery, either active or passive, by cooperating defendants. These provisions apply to public and private sector corruption. However, neither liability for corruption nor, by extension, this form of mitigation applies to corporations.[8] The CCAC reports having received “self-reports about corruption offences from private sectors,” and having investigated cases and referred them to the Public Prosecutions Office.[9]

Law no. 19/2009 (art.7) directs the CCAC to emphasize prevention. Accordingly, the CCAC “shall particularly promote: (1) the formulation of standards and procedures aiming to ensure the integrity of relevant private entities, including the codes of conduct; (2) transparency among private entities…” The Office of the Chief Executive of Macao SAR has emphasized this in its announced policy plans for 2014, stating that it will support training, dissemination of approaches to preventing private sector corruption, and the development of corporate ethics codes and related measures to strengthen integrity in the private sector.[10] CCAC regularly conducts seminars on the subject of Prevention and Suppression of Bribery in the Private Sector, targeting corporations and associations. In 2012 CCAC held a total of 70 such sessions, with 3,996 participants (CCAC Annual Report 2012, pp. 91-92). In addition, the Committee for the Registry of Auditors and Accountants, under the Financial Services Bureau, issues newsletters quarterly and specific reports on a regular basis to promote transparency in accounting, improve corporate governance, and prevent corruption and money laundering.

The CCAC has published a guide on preventing corruption for SMEs,[11] which was originally developed in Hong Kong, China. The guide offers an outline for companies to draw up their own codes of conduct, covering confidentiality, conflict of interest, exchange of favors, bribery, and disciplinary measures. It recommends basic components of an internal control system, and calls for senior management to set an ethical tone and act as role model. This is especially important for SMEs, where managers interact closely with most staff. These codes and controls are to be reinforced with a “zero tolerance” message conveyed by management, together with mechanisms for safe and prompt handling of complaints. Practical tips for avoiding corruption are offered in such areas as purchasing, tendering/contracting, commissions, inventory, and information systems.

CCAC also cooperates with a number of associations from different industries, including the Macao Chamber of Commerce, the Association of Owners’ of Maritime Navigation and Agencies of Macao, the Association of Advertising Agents of Macao, and the Service Sector Employees’ General Association of Macao. CCAC solicits the views of these organizations, explores areas of cooperation, and promotes the development of corporate corruption prevention guidelines (CCAC Annual Report 2012, pp. 93-94.).

International standard[12]	Compliance by member country
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	CCAC outreach to private sector under broad legal definition of corruption (Private Sector Bribery Law).
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) CCAC receives complaints at HQ and 2 branches, and has 24-hour hotline. 2) Prosecution may be waived for cooperation with authorities, but no mention of self-reporting or preventive steps. No corporate liability offset with penalty mitigation (CCAC Law, art.7).
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) Regular activities with private sector associations for awareness-raising and training on prevention of corruption. 2) Chief Executive: plan for developing private sector ethics code and training on prevention of private sector corruption. 3) CCAC promotes corporate integrity and transparency standards; published SME corruption prevention guide.
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	Various liaisons and activities with private sector associations, but no integrity pacts as such.

3. Internal Controls, Ethics, and Compliance

A. Internal audit

In Macao, China, internal audit is required by law for financial institutions, and mandated in concession agreements for certain other companies. Regarding financial institutions, the Monetary Authority (AMCM) issued an Internal Control Guideline (art.4.5), requiring them to perform annual internal audits. A bank's board of directors is responsible for establishing an internal audit function that effectively supervises and tests internal controls, and ensures the reliability of the bank's financial statements and reporting. Internal auditors should function independently, report to the board of directors or audit committee, and have appropriately qualified staff. In addition, the concession contracts for the gambling casinos and for a few other concessionaires, notably public utilities, contain special provisions, including the requirement of setting up an internal audit system.[13] Apart from these instances, internal audit is not expressly required even for large or public companies, although in many cases multinationals must maintain an internal audit function under the rules of their home jurisdictions or parent companies. The internal auditor must be an audit professional registered with the Committee for the Registry of Auditors and Accountants.[14]

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	Unclear, given limits on extent of internal audit requirement.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect “illegal acts” in the books and records of companies, including bribery and other forms of corruption.	1) No organized internal audit profession, but internal auditors are registered professional auditors and must comply with the relevant norms. 2) No express legislative provision, but professional audit standards address these matters.
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	1) No general company requirement. Internal audit required for banking institutions (AMCM Internal Control Guideline), and gambling and public utilities concessionaires (by contract) only. Internal auditor ensures reliability of financial statements. 2) Internal auditor supervises and tests internal controls. 3) No express legal requirement, but professional audit standards address these matters. 4) Internal auditors report to the board of directors or audit/supervision committee.

B. Audit committee

The Commercial Code (arts.214, 239-244) requires certain companies[15] to establish an independent supervisory function, but allows them the option of choosing an individual or a board of at least three persons to carry out the function. The single supervisor or one member of the board must be a qualified professional auditor or audit firm. Executives, employees, and their relations are not permitted to serve as supervisors or supervisory board members, nor may an auditor serving in this capacity be a shareholder of the company.

The supervisor has authority to oversee the administration of the company and to verify the accuracy of the annual accounts, the books and supporting documents, and the company's cash and other assets. The supervisor is required to examine and verify company accounts in order to ensure a complete and accurate audit. The supervisor must inform the directors of any irregularities or inaccuracies found in the company accounts and, if these are not corrected, inform the general meeting of shareholders. Further, the supervisor reports to the directors on the annual accounts, describing the steps taken to verify the accounts, and their results; and reporting any irregularities or unlawful acts. The Commercial Code (art.481) provides sanctions to enforce the power of the audit committee and supervisory board (or individual supervisor), penalizing corporate officers who withhold information that must be provided by law for company governance (see below).

The Internal Control Guideline issued by AMCM[16] (art.5), applicable to financial institutions only, requires the establishment of an audit committee. The committee oversees a bank's internal and external auditors, and reports directly to the board of directors. The committee is also responsible for ensuring the management takes prompt corrective action to address internal control weaknesses, non-compliance with policies, laws and regulations, and other problems identified by the auditors.

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	1) Certain companies to have single supervisor or committee per Commercial Code. Banks: audit committee per AMCM Guideline. 2) Committee must include a qualified professional auditor or firm.
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers, employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	1) Supervisor to examine and verify company accounts, report to the directors. Banks: committee oversight of internal, external auditors. 2) Supervisor to oversee administration of the company, inform directors of any irregularities or inaccuracies found in the company accounts. 3) No requirement. 4) Banks: committee to ensure prompt corrective action to address internal control weaknesses, non-compliance with policies, laws and regulations. 5) CCAC voluntary standards for SMEs (see below): complaints channel.

C. Internal control and compliance systems

In general, companies in Macao, China are not legally required to establish internal control systems. However, internal control is a requirement for financial institutions under the AMCM Internal Control Guideline (art.1.2): "banks are encouraged and required to establish, maintain and operate an effective system of internal control that is appropriate to the size of the bank and the nature, scope, and risk of its activity." The Guideline recognizes that small institutions are likely to have less complex structures than the largest banks, but their systems for internal control are expected to be just as effective. AMCM undertakes to "closely monitor and evaluate the quality and effectiveness of banks' internal control system." Further, the AMCM Guideline on Financial Disclosure[17] (art.5) requires every financial institution to implement a disclosure policy that includes the release of information on internal control systems.

Outside the banking sector, internal control systems are assumed rather than explicitly required. Many of the large companies in the region are subsidiaries or branches of foreign corporations, and therefore must follow the guidelines applicable to their parent companies, including internal control provisions.

Indeed, such controls can reasonably be viewed as necessary for all but the smallest enterprises to meet corporate governance and financial reporting standards – but as in the banking sector, an affirmative requirement is advisable. Macao, China's Auditing Standards [18] include, as a necessary function of the statutory audit, assessing a company's internal control systems. The Technical Auditing Standards [19] call for the auditor to obtain an understanding of the audited firm's internal control systems, and to document this along with auditor's assessment of control risk. Based on testing, the auditor is to evaluate whether the internal controls are designed and operating as expected, and apprise management of any material weaknesses. Statutory audits under these rules are required of all companies that have supervisory boards, including companies that have 10 or more shareholders, issue bonds or have the form of a public company.[20]

As for the features of the internal control system, once again, these are specified only for financial institutions – in the Internal Control Guideline. Such a system should enable a bank to determine whether, for example, recorded transactions and financial reports are accurate; its risk management systems are effective; and the bank complies with applicable laws and regulations, internal policies and procedures. (art.2). Further, the financial institution's board of directors should periodically discuss with management the effectiveness of the internal control system, and ensure prompt follow-up on relevant concerns of such stakeholders as regulators and shareholders. Internal controls may need to be revised to address new risks posed by innovations and other changes in the context (arts.4.1, 4.2). While these provisions are relatively robust, it is a major concern that they (or equivalent rules) do not apply to other sectors, especially the gambling industry with its risks of fraud, corruption, and money laundering.

The CCAC Guide for SMEs on preventing corruption,[21] discussed previously, is relevant in this context as well. The Guide presents voluntary standards. It includes recommendations on internal controls covering record-keeping, job definitions, work procedures, monitoring and review, and channels for complaints. It also recommends an ethics code and an approach to company-wide commitment beginning with an ethical "tone at the top."

International standard	Compliance by member country
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees. 4) Risk-based approach: • Individualized assessment of risks to the enterprise, including corruption risks. • Regular monitoring and re-assessment of corruption risks.	1) Systems expressly required for financial institutions only, per AMCM Guideline. Banks to disclose information on internal controls. Listed companies and companies of subsidiaries or branches of other listed companies are required to disclose information on internal controls. 2) Requirement to assess and test internal controls in statutory audit for above companies.[22] 3) CCAC voluntary standards for SMEs: ethics code and "tone at the top." 4) No explicit requirement though generally considered part of the external audit scope.
Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements. 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations. 4) Require for third-party representatives, consultants, or agents:	1) Banks: systems to assess compliance with laws and controls. 2) CCAC voluntary standards for SMEs: guidance to prevent fraud and corruption. 3) and 4): No requirements, though CCAC investigations have found that many companies have introduced such guidance.

• Written contract, adherence to company ethics standards and anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	
Enforcement, including sanctions for failure to comply.	No enforcement provisions.

4. Integrity of Financial Statements

A. Accounting

1. Financial records

The Commercial Code[23] (arts. 46-57) imposes formal bookkeeping requirements on all businesses, with a compulsory retention period of ten years (a period that continues, if necessary, beyond the life of the enterprise or the entrepreneur). A business must prepare regular accounts at least annually, and these must be signed by the individual entrepreneur, or by the executives in the case of a company. In addition, the Code (art.482) stipulates penalties for any enterprise supplying false information in response to a legal disclosure requirement (see below).

The Statute of Professional Accountants (arts.23, 67) makes auditors and audit firms responsible to the Tax Administration Department for correctly handling accounting documents. These professionals may not "engage in activities, that directly or indirectly, lead to the concealment, destruction, invalidity, forgery of the accounts, accounting documents, and the respective tax returns." Violations are subject to immediate cancellation of the professional's license. The prohibitions applied to enterprises and accountants may well include all of the matters contained in international standards (table below), but it may be worth making the specific prohibitions explicit, especially for businesses.

International standard	Compliance by member country
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	Formal requirements and 10-year retention period for financial records per Commercial Code.
Prohibitions (UNCAC 12(3), OECD Convention 8(1), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	Prohibitions per Commercial Code and Accountants Statute: 1) False information in disclosure (business). 2) Forgery, destruction of accounting documents (accountant). 3) through 6): Individual offenses not specified but accountants subject to prosecution for concealment of accounts.

2. Financial reporting requirements

Macao, China officially began its adoption of IFRS with legislation enacted in late 2005, and the application of some 16 of these standards as of 2012. Macao has no plans for the full adoption of IFRS but, rather, plans to continue selective adoption of individual standards.[24] The Accounting Standards Regulation[25] (arts.1-4) requires companies such as the following to use the adopted IFRS:

- Concessionaires (this includes the gambling industry).
- Financial institutions and insurance companies.
- Public companies.
- Others including offshore companies and partnerships limited by shares.

Enterprises not meeting the above criteria, but required by other laws to meet accounting standards, may choose to use IFRS or Macao's General Financial Reporting Standards (based on IFRS with local adaptations). Others need only meet the minimal standards of the Commercial Code.

Companies have a duty to disclose their material contingent liabilities under both IFRS and the GFRS of Macao. GFRS 8 closely mirrors the relevant IFRS provision, IAS 37 including its materiality criterion. The AMCM Disclosure

Guideline [26] applicable to financial institutions further requires a formal disclosure policy approved by its board of directors. The disclosure policy should present the relevant internal controls and procedures. Disclosures must include off-balance sheet exposures and derivatives transactions, and for branches of foreign institutions, consolidated assets, liabilities, and profits. There appears to be no equivalent to this last set of requirements for non-financial companies, since the GFRS do not incorporate the relevant international standard, IFRS 10.

International standard	Compliance by member country
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) IFRS partially adopted, apply to public companies, concessionaires and financial institutions. 2) IFRS for SMEs not adopted. SMEs may choose IFRS or updated local standards. 3) Disclosures of off-balance sheet, affiliate company and related transactions required only of financial institutions.
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) GFRS 8 equivalent to IAS 37, requiring disclosure of material contingent liabilities per IFRS. 2) and 3): Not required by GFRS.

B. Audit

1. Auditing requirements

The Statute of Registered Auditors [27] (arts.20-26) describes the statutory (independent) audit, which should culminate in the legal certification of the audited company's financial accounts. The companies that must undergo a statutory audit include public enterprises, public service concessionaires, and as discussed above, companies that have supervisory boards (as stipulated in the Commercial Code). The last group encompasses companies that have ten or more shareholders, issue bonds or have the form of a public company. Other companies are required to do external audits by special enactment, including Group A companies under the Law on Profit Tax (No. 21/78/M).[28] Further, the

Commercial Code (art.481) penalizes corporate officers who withhold information that must be provided by law for company governance functions such as audit (see below).

The Auditing Standards Decree [29] imposes such obligations as thoroughly understanding the audited business, assessing internal control systems, providing an opinion (with or without reservation), and disclosing the methodology and evidence used. Auditors must also pay attention to legal compliance and to the risks and occurrences of fraud. The Technical Auditing Standards[30] flesh these points in detail, including the “Consideration of Laws and Regulations” consistent with ISA 250 (Annex sec.4). Thus, the auditor is to identify and address instances of noncompliance with laws and regulations, in particular those having an effect on the determination of material amounts and disclosures in the financial statements. The auditor is also to assess the entity's accounting and internal control systems, and inform management of any material weaknesses in the design or operation of the accounting and internal control systems (Annex, sec.6). The technical standards, however, contain no equivalent to ISA 240 detailing the auditor’s duty to address fraud.

Additional requirements are applied to the gambling and financial sectors. Six concession contracts govern the casino industry. The sample contract cited previously[31] includes provisions on internal audit, annual external audit, and special audits (as determined by the Finance Department or Gaming Inspection and Coordination Bureau). The latter two audits are to be done by an “internationally reputed” firm approved by the above regulators. Last, the concessionaire is required annually to publish its accounts in the government gazette and two newspapers. Standards of audit are not addressed in the sample contract; thus the Auditing Standards Decree and Technical Auditing Standards apply.

The Macao Financial System Act[32] imposes compulsory external audit and publication of accounts on the banking sector (arts.53-57). AMCM manages the roster of approved audit firms and monitors the audit engagements. Auditors are required to inform AMCM immediately if they detect anything that may cause serious damage to the financial institution or sector, including criminal activities, money-laundering,[33] and irregularities that create significant risk of insolvency. The banks are required to publish their accounts in the same fashion as the gambling concessionaires (arts.74-77), with a few additional disclosures.

There appear to be no audit standards tailored to smaller enterprises. Comprehensive standards apply only to banks. Last, although Macao’s system is in certain respects harmonized with the International Standards of Audit, the full adoption of the ISAs does not appear to be on the agenda.

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	Auditing controls appear insufficient in light of risks.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	1) Group A companies are required to have external audits. Concessionaires and financial institutions are required to publish accounts. 2) No audit requirement for businesses not registered as companies, absent special legislation.
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	Audit Decree and Technical Auditing Standards include provision similar to ISA 250. Duty to examine evidence of fraud stated (per ISA 240) but not spelled out in detail.
Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks. 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	1) Certification of financial reports, opinion on report quality, and identification of internal control weaknesses required per Audit Decree and Technical Auditing Standards. 2) Penalties for corporate officers withholding information or supplying misleading information.

2. Auditor reporting of improprieties

The clearest duty to report possible corruption externally is provided in the Macao Financial System Act as mentioned above, which applies to financial institutions. Auditors are required to report any involvement by the audited bank or its personnel in criminal activities or money-laundering, as well as any irregularities that may put the solvency of the institution immediately at risk. The standard of "materiality" here is whether any of these improprieties could cause serious damage to the financial institution or jeopardize the soundness of the financial system.

In addition, auditors have an explicit duty to report to the Public Prosecutor evidence of crimes acquired during the course of professional work.[34] Further, the Anti-Money Laundering Instructions require auditors (as well as accountants and tax consultants) to report any indications of money laundering within two days to the Office of Financial Intelligence. Failure to do so is subject to substantial fines.

Apart from these instances, the mechanism for auditors to alert outsiders is to include reservations or qualifications in the audit report. The Auditor Code of Ethics (art.7) exempts the auditor from the duty of confidentiality in order to report "infringements of laws to regulatory authorities, in accordance with the provisions of laws or judicial order." This follows ISA 250 in enabling such reporting, but without stating an affirmative duty or establishing a safe harbor.

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	Auditor to report evidence of legal non-compliance to management and supervisor/committee per Technical Auditing Standards.
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").	1) Reporting is possible under provision similar to ISA 250, and a general duty to report crimes applies. Banks: auditors must report crimes and material irregularities to regulator, report money laundering to Office of Financial Intelligence. Material: risk of serious damage to institution or financial sector. 2) No safe harbor, though financial institutions may be partially protected by legal reporting duty. General criminal provisions on protection and liability of whistleblowers apply.

C. Professional standards and independence

The accounting profession in Macao, China is governed by the Statute of Registered Accountants[35] and supervised by the Committee for the Registry of Auditors and Accountants (CRAC) in cooperation with the Department of Public Auditing, Tax Investigation and Appeals of the Financial Services Bureau.[36] In order to engage in practice, accountants and accounting firms must be registered with CRAC (arts.1-12, 75). The demand for professional accountants in Macao, China's growing economy cannot be met by the locally-registered accountants (estimated at 148 in 2007). Foreign professionals and firms have a presence there, and accounting professionals are drawn especially from Hong Kong, China.[37]

The Accountants Statute stipulates a number of ethical duties and restrictions applicable to accountants. Registered accountants (independent professionals), accounting technicians (in-house bookkeepers), and accounting firms are prohibited from performing audits, in particular the legal certification of company financial statements (arts.15-26). An accountant who has lost her/his registration may not be a shareholder in an accounting firm, nor may professional auditors join professional associations of registered accountants or accounting technicians (arts. 58, 61, 65). The regulations on accounting standards reinforce these rules of conduct and call for CRAC to draft a Professional Code of Ethics for Accountants. [38] The Macao Society of Registered Accountants represents the profession and supports professional development. [39]

The profession of independent auditor is addressed in the Statute of Registered Auditors and related documents. The Statute requires registration with CRAC of all practicing auditors and audit firms on an annual basis (arts.1-19). Foreign auditors and firms are provided a reasonable basis to qualify and register in Macao.[40] The auditor's duties (arts.20-23) include the issuance of a legal certification of the accounts. The auditor must act "with complete independence," and is irremovable except by consent or based on sufficient reasons. An audit may not be conducted where the individual auditor or an auditor-shareholder of an audit firm has held a position in the audited company within the last three years, nor may the auditor take a job with the client firm within three years following the audit. Audits are also barred if the auditor (or a relative) has a shareholding of over 10% in the client firm, or is an officer or director of the client company (arts.31-78). Allowing an auditor to own up to 10% of an audited company is quite unusual internationally (most statutes review in this study permit no shareholding at all), and seems to pose a risk to the auditor's objectivity.

The Statute defines basic norms of conduct including the duty to protect confidentiality. Auditors must facilitate the tax authority's examination of accounts, and tax returns, and avoid any concealment or manipulation of audit, accounting, or tax documents. An audit firm's shareholders – all of whom must be qualified auditors in good standing – are subject to joint and several liability for the firm's debts, penalties, and damages. Compliance with the Statute is supervised by CRAC and the Department of Public Auditing, Tax Investigation and Appeals of the Financial Services Bureau, with an array of sanctions specified for malpractice (see below). Auditors' ethical duties receive further reinforcement in the Code of Ethics for Registered Auditors,[41] enacted pursuant to the Statute.

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) Professional registration, supervision, discipline per Accountants Statute. 2) Ethical rules per Accountants Statute, oversight by CRAC and profession-based bodies.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	Auditor Statute provisions on: 1) Appointment and independence of auditor. 2) and 3): No provisions. 4) Auditor interests in audited firms: up to 10% permitted. 5) Employment of former auditors by audited firms barred for 3 years.
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	CRAC oversight, per Auditor Statute: 1) Registration, qualification, etc. of auditors and audit firms. 2) Code of ethics. 3) Supervision of legal compliance by CRAC. 4) Sanctions for violations, malpractice.

D. Enforcement

The Commercial Code (arts. 473-488) penalizes the withholding of information, misstatements, and attempts to mislead in financial disclosures to auditors, committees, and others. Maximum penalties range from three months' to a year's imprisonment, and fines amounting to 60 to 120 days' fine,[42] depending on the circumstances and whether the company has been harmed. Similar penalties apply to those issuing false information and obstructing supervision. Penalties are compounded for maliciously providing false information, and for doing so with the intention of causing serious damage to a shareholder or company. Penalties apply to the responsible individual.[43]

Additional sanctions are available to AMCM for violations by regulated financial institutions. The Macao Financial System Act (arts.122-138) stipulates fines for banks obstructing supervision by AMCM, refusing to provide information or providing false information to AMCM. Fines may be doubled for repeat offenses, and where the monetary benefit due to the violation is high, twice the amount of the benefit may be levied as a fine. The penalties apply to individuals as well as institutions. In addition, regulatory actions such as withdrawal of licenses or closure of institutions are available.

Enforcement penalties are also provided, in the Accountant and Auditor Statutes, for offenses by individual professionals, firms, and associations. Under the Statute of Registered Accountants (arts.65-87), significant deficiencies in tax returns and abandonment or refusal to sign accounts constitute negligence, for which the penalty is a fine of up to MOP 200,000 (USD 25,000). Gross negligence, including breach of confidentiality and material discrepancies between financial statements and records, can result in suspension of an accountant’s license. The professional license may be cancelled in cases of serious damage to clients, intentional concealment, forgery, or destruction of records. The Statute of Auditors (arts.84-94) provides sanctions against auditors who engage in malpractice. Fines of up to MOP 500,000 (USD 61,000) apply to instances of negligence such as unjustified refusal to perform a statutory audit or failure to cooperate with the tax authorities. Suspension and cancellation of the professional registration apply in the same way as to accountants. The Anti-Money Laundering Instructions (art.12) also stipulate penalties for auditors and accountants who fail to report possible money laundering activities.

International standard	Compliance by member country
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2): Several of the provisions on accounting and audit are consistent with international standards, though not all.
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Penalties up to 1 year's imprisonment and 120 days' salary for false or misleading financial statements, per Commercial Code. Accountants: fines up to USD 25,000 or suspension/cancellation of license for negligence. Penalties compounded where intent to harm or actual damage to shareholders or third parties is shown, per Commercial Code and Accountants Statute. 2) Application to companies unclear. Banks: corporate liability and penalties per Financial System Act. 3) Enforcement authority: CRAC, Financial Services Bureau, AMCM, referral to prosecution.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) As above, but auditor malpractice subject to fines up to USD 61,000. 2) and 3): As above.

5. Conclusion and Recommendations

A. General efforts to prevent corruption involving the private sector

Macao, China's anti-corruption agency, the CCAC, has taken the lead in this area. CCAC has made some laudable efforts in reaching out to strengthen private sector capacities for preventing corruption. The Chief Executive of the SAR has supported these efforts with plans for training and awareness-raising in this area. CCAC's efforts are bolstered by the requirements of Macao, China's law on private sector corruption to work with business, and also to waive prosecution for a defendant's providing critical evidence.

Recommendations

1) Increase public-private cooperation against corruption, including promotion of business codes of ethics, and partnerships to develop corporate compliance models.
2) Promote private sector integrity pacts. Develop and disseminate best practice models of such pacts in public procurement, concessions, and other appropriate areas.

B. Internal Controls, Ethics, and Compliance

Macao, China has put in place some of the necessary components for an effective regime for corporate internal control and compliance. Certain companies are required to have supervisors or audit committees to oversee such regimes. Internal audit requirements apply only to banks and to concessionaires such as casino operators, and internal control requirements only to banking institutions.

Recommendations

1) Extend the legal requirement of internal audit beyond the financial sector. Place the requirement for concessionaires on a firmer statutory basis. Include review of risks of fraud, illegality, and corruption in internal audit requirements.
2) Require audit/supervision committees to have complaint-handling systems and to provide staff guidance on preventing corruption. Extend the provisions applicable to banks on oversight of audits and corrective action to other sectors.

3) Extend the requirement of internal control systems beyond the banking sector, especially to the gambling industry. Clarify that external auditors are to test the internal controls as part of the regular audit. Require efforts to ensure company-wide support for compliance, risk-based approaches, and rules on gifts, use of agents, and other risky areas (beyond the voluntary SME standards).

C. Integrity of Financial Statements

Accounting and financial reporting standards are improving since Macao, China partially adopted the IFRS and intends to phase in others over time. The local version of these standards, which appears to diverge little from the IFRS with regard to the standards adopted, applies to public companies and the most sensitive sectors. In terms of external audit, the adoption of the ISAs as such is not on the agenda. The existing standards apply to many companies but not all, and there are no standards adapted for SMEs. Audit opinions are required, but the certification of accounts by company management is not. Importantly, corporate liability is not clearly provided for accounting and auditing irregularities that could enable the concealment of fraud and corruption.

Recommendations

1) Adopt the full IFRS, or at least a more complete version including IFRS 10 and IFRS for SMEs. Adopt explicit prohibitions on off-the-books accounts and deceptive accounting entries.
2) Adopt the ISAs, especially ISA 240. Clarify to which enterprises statutory audit and related standards apply, and develop audit standards for SMEs.
3) Go beyond the ISAs to require and protect auditor disclosure to external authorities of fraud, illegality, and corruption.
4) Require certification and signature of accounts by corporate CEO or CFO.
5) Adopt clear and stringent provisions on corporate liability for financial reporting and auditing offenses.

Macao, China Laws, Regulations, Policy Documents Referenced:

Accounting Standards, Approval of the Accounting Standards, Administrative Regulation No.25/2005 , www.dsf.gov.mo/crac/Publish/Leg_Vigor/files/e_Reg_25_2005.pdf.

Auditing Standards, Approval of the Auditing Standards, Administrative Regulation No.23/2004, www.dsf.gov.mo/crac/Publish/Leg_Vigor/e_Reg_23_2004.htm

Code of Ethics for Registered Auditors, www.dsf.gov.mo/crac/Publish/Leg_Vigor/files/e_Reg_36_2004.pdf.

Corruption Prevention Guide for SMEs in Guangdong, Hong Kong and Macao, www.ccac.org.mo

Commercial Code, Approved by Decree-Law no. 40/99/M, of August 3 (as amended), http://bo.io.gov.mo/bo/i/99/31/codcomen/codcom0001.asp.

Guideline on Disclosure of Financial Information, 026/B/2012-DSB/AMCM.

Guidance to General Financial Reporting Standards, http://www.dsf.gov.mo/crac/Leg_Vigor.aspx.

Internal Control Guideline for Authorized Credit Institutions, www.amcm.gov.mo/rules_and_guidelines/laws/bank/En_Cir_169_B_02.pdf

Instructions for prevention and suppression of money laundering and financing of terrorism for auditors, accountants and tax consultants in MSAR, www.dsf.gov.mo/crac/Publish/Leg_Vigor/files/e_aviso_STR.pdf.

Law on Prevention and Suppression of Bribery in the Private Sector Law (Law no. 19/2009), www.ccac.org.mo.

License Contract of Macao Special Administrative Region for the Operation of Games of Fortune or Chance or Other Casino Games, www.dicj.gov.mo/web/en/contract/SJM/2002_BORAEM014S2Sup.html.

Macao Financial System Act, Decree-Law no. 32/93/M, 5 July 1993, www.amcm.gov.mo/rules_and_guidelines/laws/bank/En_Lw_32_93.pdf

Organic Law of the Commission Against Corruption of the Macao Special Administrative Region, Law no. 10/2000 of 14th August (as amended), www.ccac.org.mo.

Statute of Registered Accountants – Approval of the Statute of Accountants (1999), Decree-Law No.72/99/M, www.dsf.gov.mo/crac/Publish/Leg_Vigor/e_Lei_72_99_M.htm.

Statute of Registered Auditors, www.dsf.gov.mo/crac/Publish/Leg_Vigor/e_Lei_71_99_M.htm .

Technical Auditing Standards, Approval of the Technical Auditing Standards, Resolution of the Secretary for Economy and Finance

No.68/2004
www.dsf.gov.mo/crac/Publish/Leg_Vigor/e_Desp_68_2004.htm

Technical Guidelines. Approval of the Technical Guidelines for the Application of Technical Auditing Standards, Resolution of the Secretary for Economy and Finance No.69/2007
www.dsf.gov.mo/crac/Publish/Leg_Vigor/files/e_despsef-69-2007.pdf

NOTES

[1] www.ccac.org.mo.

[2] Direct taxes from gaming accounted for 81.6% of total public revenue in 2010, for 83.5% in 2011, for 82.6% in 2012, http://www.dsf.gov.mo/finance/public_finance_info.aspx?FormType=0.

[3] O'Keefe, Kate, "Macau Government Limits Casino Expansion," Wall Street Journal, March 26, 2010, http://online.wsj.com/news/articles/SB10001424052748704094104575143332697415448; "A window on China," *The Economist,* Dec. 10, 2011, http://www.economist.com/node/21541417; Chiang, Chuck, "Booming success of Macau's gaming industry facing challenges," *Vancouver Sun*, July 28, 2013, http://www.vancouversun.com/business/Booming+success+Macau+gaming+industry+facing+challenges/8718742/story.html.

[4] *Vulnerabilities of Casinos and Gaming Sector – March 2009*, the latest available report by FATF/OECD and APG, states (page 15), "The competent authorities responsible for the regulation of the casino sector are the Gaming Inspection and Coordination Bureau (DICJ) and the Judiciary Police. Criminal investigation of money laundering activities is undertaken by the Judiciary Police, whilst the preventative measures against money laundering are the responsibility of the DICJ. For currency exchange activities inside the casinos, they are under the supervision of the Monetary Authority of Macao. Macao, China has introduced a licensing system to regulate junket operators…All casinos, junket operators and currency exchange counters inside the casinos have the duty to report Suspicious Transaction Reports to the Financial Intelligence Office of Macao, China. At the same time, casinos and junket operators have to submit large transaction reports to the Gaming Inspection and Coordination Bureau." Comments and information provided by government.

[5] Although there is no domestic stock exchange, the main gambling companies are listed directly or indirectly in leading global securities markets such as the Hong Kong Stock Exchange. Government comments.

[6] CCAC (2013), *Annual Report of the Commission Against Corruption of Macao 2012*, p. 100.

[7] Organic Law of the Commission Against Corruption of the Macao Special Administrative Region, Law no. 10/2000 of 14th August (as amended) (CCAC Law), art.7, www.ccac.org.mo.

[8] The ADB/OECD Thematic Review on the topic of criminalization found that Macao, China did not impose liability for corruption on corporations. ADB/OECD Anti-Corruption Initiative for Asia and the Pacific (2010), “The Criminalisation of Bribery in Asia and the Pacific,” Thematic Review, Final Report, p321. As of early 2014, this is still the case. Criminal liability of legal persons has not yet been established for offences of corruption in Macao, except the organized bribery as regulated at Law 6/97/M notwithstanding the criminal liability of legal persons on crimes of money laundering, initially established by Law no. 6/97/M and currently stipulated in Law no. 2/2006, including cases where the predicate offence is bribery. Information and comments provided by government.

[9] http://www.ccac.org.mo.

[10] http://www.gce.gov.mo/downloads/pt2014_policy.pdf.

[11] *Corruption Prevention Guide for SMEs in Guangdong, Hong Kong and Macao*, www.ccac.org.mo.

[12] The sources of all standards are provided in footnotes to the tables presented in the section of the Review entitled *International Standards for Country Reports.*

[13] Government survey response. An example of one such contract appears at: www.dicj.gov.mo/web/en/contract/SJM/2002_BORAEM014S2Sup.html.

[14] Government comments. Further, internal audit is subject to the set of rules governing auditors (http://www.dsf.gov.mo/crac/Leg_Vigor.aspx).

[15] Those that have ten or more shareholders, issue bonds, or are public companies.

[16] http://www.amcm.gov.mo/rules_and_guidelines/laws/bank/En_Cir_169_B_02.pdf

[17] *Guideline on Disclosure of Financial Information*, 026/B/2012-DSB/AMCM (art.6).

[18] *Approval of the Auditing Standards*, Administrative Regulation No.23/2004, http://www.dsf.gov.mo/crac/Publish/Leg_Vigor/e_Reg_23_2004.htm.

[19] *Approval of the Technical Auditing Standards*, Resolution of the Secretary for Economy and Finance No.68/2004 www.dsf.gov.mo/crac/Publish/Leg_Vigor/e_Desp_68_2004.htm.

[20] *Statute of Auditors*, Decree-Law no.71/99/M (art.24), http://www.dsf.gov.mo/crac/Publish/Leg_Vigor/e_Lei_71_99_M.htm. Government comments.

[21] Corruption Prevention Guide for SMEs in Guangdong, Hong Kong and Macao, www.ccac.org.mo.

[22] According to government comments, this applies also to companies in Group A established under the Law on Profits Tax, art.4, http://bo.io.gov.mo/bo/i/78/36/lei21.asp#21.

[23] http://bo.io.gov.mo/bo/i/99/31/codcomen/codcom0001.asp.

[24] http://www.ifrs.org/Use-around-the-world/Documents/Jurisdiction-profiles/Macao-IFRS-Profile.pdf.

[25] Administrative Regulation No.25/2005 - Accounting Standards, www.dsf.gov.mo/crac/Publish/Leg_Vigor/files/e_Reg_25_2005.pdf. Early in its IFRS adoption, Macao, China was reported to apply them as well to companies with share capital of MOP 1 million or USD 122,814 (Iwase 2007).

[26] Guideline on Disclosure of Financial Information, 026/B/2012-DSB/AMCM (arts.5-7, 14).

[27] http://www.dsf.gov.mo/crac/Publish/Leg_Vigor/e_Lei_71_99_M.htm .

[28] Government comments.

[29] Approval of the Auditing Standards, Administrative Regulation No.23/2004, http://www.dsf.gov.mo/crac/Publish/Leg_Vigor/e_Reg_23_2004.htm.

[30] Approval of the Technical Auditing Standards, Resolution of the Secretary for Economy and Finance No.68/2004 www.dsf.gov.mo/crac/Publish/Leg_Vigor/e_Desp_68_2004.htm. Further detail on procedure and documentation is provided in the Technical Guidelines. Approval of the Technical Guidelines for the Application of Technical Auditing Standards, Resolution of the Secretary for Economy and Finance No.69/2007 www.dsf.gov.mo/crac/Publish/Leg_Vigor/files/e_despsef-69-2007.pdf.

[31] www.dicj.gov.mo/web/en/contract/SJM/2002_BORAEM014S2Sup.html.

[32] Decree-Law no. 32/93/M, 5 July 1993, www.amcm.gov.mo/rules_and_guidelines/laws/bank/En_Lw_32_93.pdf.

[33] In the case of money-laundering, auditors are required to inform the Financial Intelligence Office (GIF).

[34] Statute of Registered Auditors, enacted by Decree-Law no. 71/99/M, art.37(c), http://www.dsf.gov.mo/crac/Publish/Leg_Vigor/e_Lei_71_99_M.htm.

[35] Approval of the Statute of Accountants (1999), Decree-Law No.72/99/M, www.dsf.gov.mo/crac/Publish/Leg_Vigor/e_Lei_72_99_M.htm.

[36] Functioning as a Ministry of Finance.

[37] Iwase, Lois (2007), “All Change for Macau’s Accountants,” A+, Feb.: 28-29, http://app1.hkicpa.org.hk/APLUS/0702/28.pdf.

[38] Administrative Regulation No.25/2005 - Accounting Standards, www.dsf.gov.mo/crac/Publish/Leg_Vigor/files/e_Reg_25_2005.pdf.

[39] http://www.acrm.org.mo/e_about_us.htm.

[40] Examination and internship requirements apply but may be waived, as has been the case with many Hong Kong audit professionals (Iwase 2007).

[41] www.dsf.gov.mo/crac/Publish/Leg_Vigor/files/e_Reg_36_2004.pdf.

[42] Under the penal system of Macao, China the actual amount of a fine is determined by the number of days, multiplied by a daily amount, to be decided by the court, taking into consideration the economic and financial status of the offender, but not less than MOP 50 (USD 6) and not exceeding MOP 10,000 (USD 1,230) per day.

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Malaysia

1. Introduction

Malaysia has become a manufacturing-based, export-driven economy driven by knowledge-based and capital-intensive industries. To move the country forward, the Government has crafted a framework including the New Economic Model, intended to propel Malaysia to become an advanced nation characterized by inclusiveness and sustainability, and the Government Transformation Programme to strengthen public services.

Malaysia is working to sustain its economic success as it struggles internally over the ways in which economic competition and openness could carry over into politics and government. Malaysia has entered the upper-middle income category by World Bank metrics.[1] The country's banking system and capital markets are differentiated, well capitalized, open to domestic and foreign capital, and regulated in line with international standards. The state continues to play a major role in the economy, controlling strategic sectors and administering prices for goods such as rice, sugar, liquefied natural gas, and refined fuels. But current policy calls for increased privatization, and in 2011 major divestments were completed in the highways, auto, pharmaceutical, and financial services sectors.[2]

Significant governance challenges remain, however. Competition in the marketplace is limited by a long-standing policy of affirmative action quotas and preferences for the *bumiputera* (indigenous population, largely Malays). Thus, government contracts, privatizations, and investment projects usually require bumiputera participation. The liberalization of a few service sectors in 2012 is meant to ease part of this pressure by permitting businesses to operate free of such equity participation quotas. International observers, however, remain concerned about patronage and lack of transparency in large public investment projects.[3]

The government has identified corruption as a serious problem in the public sector, although overall levels of corruption in the civil service are thought to be relatively low for the region. The Malaysian Anti-Corruption Commission Act (MACCA), adopted in 2009, replaced an earlier framework with one aimed at strengthening anti-corruption enforcement and making the MACC more transparent, accountable, and independent in its operations. Malaysia has adopted several relevant reforms in recent years, including the Whistle-blowers Protection Act 2010, and the convicted Corruption Offenders Database. These efforts enabled Malaysia to improve its ranking in the Transparency International Corruption Perceptions Index from 60th to 53rd position in 2011-2013.[4]

The Government's transformation plan helps to improve the public and investors' perception towards Malaysia particularly in the area of transparency and competitiveness. Malaysia was ranked in sixth position among 189 economies on the overall measure of Ease of Doing Business, according to the latest World Bank *Doing Business Report 2014*.[5]

2. General efforts to prevent corruption involving the private sector

A host of business-related anti-corruption initiatives have been launched over the past several years. In 2004, the government established the Integrity Institute of Malaysia (IIM), a center for research, advice to government, and outreach to the public on corruption and integrity issues. IIM carries out government action plans in this area and organizes seminars and workshops for citizens and companies to encourage participation in anti-corruption work. The government in 2007 launched PEMUDAH, a public-private sector initiative to identify and address bureaucratic obstacles, simplifying business operations in Malaysia by improving government services. Procurement bidders can access several complaint mechanisms through the MACC, the Public Accounts Committee, and procuring agencies, which can cancel tenders if irregularities are revealed. The Public Complaints Bureau, established in 1971 under the Prime Minister's Office, functions as an online ombudsman site where individuals can lodge complaints against government departments and agencies.[6] Further, the government is empowered to blacklist an errant company registered with the Ministry of Finance for up to five years.[7]

The government adopted a Code of Corporate Governance in 2000, which has twice been updated, most recently in 2012. The code sets out broad principles and specific guidance on structures and processes that companies should adopt to make good corporate governance an integral part of their business dealings and culture. Several key recommendations are being implemented through the *Bursa Malaysia* (Stock Exchange) Listing Requirements. Publicly listed companies must explain how they have complied with the recommendations in the code or explain why they have not. The new code is part of a 5-year action plan adopted by the Securities Commission Malaysia and aimed at raising corporate governance standards in Malaysia. Bursa Malaysia has also established accreditation and continuing education programs for capital market participants, which are reported to have contributed to a higher awareness of governance and anti-corruption issues.[8]

The Companies Commission Malaysia established the Corporate Law Reform Committee with responsibility for the publication of the *Consultative Document on Creating a Conducive Legal and Regulatory Framework for Business*. The document recommended maintaining the statutory audit requirement for all companies. The Commission has been actively encouraging deregistration of dormant companies, in particular, by waiving applicable penalties for failure to lodge financial statements. As a result, 200,000 companies were removed from the register.[9]

Under its current reform agenda (GTP 2.0) the government plans to introduce a corporate liability provision into the MACC Act 2009, thus bringing Malaysia's anti-corruption legislation in line with international good practice standards as prescribed under Article 26 of UNCAC, as well as the US Foreign Corrupt Practices Act and the UK Bribery Act 2010. This provision holds companies liable for employees indulging in corrupt practices in order to secure contracts or businesses for their companies.[10]

A recent achievement was the introduction of the Corporate Integrity Pledge in 2011, the result of collaboration between several government bodies, including MACC, the Prime Minister's Office, and the Performance Management and Delivery Unit. As of February 2014, 386 companies have signed the pledge.[11] Being listed in the register of signatories demonstrates a company's commitment to uphold the anti-corruption principles and to keep its business operations free of hidden risks or costs that are associated with corrupt activities. The register appears on the website of IIM, and can be accessed through the website of Bursa Malaysia. There are also integrity pact initiatives with respect to government procurement, supported by the Ministry of Finance, with guidance on approaches to be used in ordinary procurements. As part of this initiative, through the Committee of Management Integrity and Governance for Mega Projects, the MACC monitors procurements worth MYR 500 million (USD 150 million) and above.[12]

In addition, there are a range of private sector and civic initiatives. The Malaysian Institute of Corporate Governance conducts corporate governance training programs. A minority shareholder watchdog group — Badan Pengawas—is working to raise corporate governance standards, as well as to monitor and combat abuses by insiders against the minority. The Malaysian International Chamber of Commerce and Industry has established a business ethics committee to provide education and support for members seeking to enhance their governance.[13]

International standard[14]	Compliance by member country
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	Several initiatives moving forward from government, private, and civic sectors – largely under government influence.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) MACC, Public Accounts Committee, Public Complaints Bureau provide channels for complaints and information. Whistleblower and witness protection legislation in place. 2) Under the MACCA (art.52) evidence of accomplices and *agents provocateurs* is admissible in court, and (art. 62) a court may issue a certificate of indemnity to offenders if required to give evidence as witnesses for the prosecution
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) MACC and IIM provide research, guidance, and training on corruption prevention. 2) NGOs and business associations provide training and advocacy on corporate governance and transparency. 3) Code of Corporate Governance adopted, revised, and incorporated into Listing Requirements by Securities Commission.
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	Corporate Integrity Pledge and related procurement integrity initiatives have registered over 386 company signatories. Integrity Pact mechanism is being implemented through Treasury Circular Letter No.10 of 2010 for government procurement.

3. Internal controls

A. Internal audit

Companies in general are required by law to maintain a system of internal control. Most companies comply through the setting up of an internal audit function. An internal audit function is recommended for all companies by the Code on Corporate Governance and required of listed companies under the Bursa Malaysia Listing Requirements.[15] Recommendation 6.2 of the Code calls for the board of directors to establish an internal audit function reporting directly to the audit committee. The head of internal audit should be responsible for providing assurance to the board that the internal controls are operating effectively. Internal auditors should follow recognized professional standards and conduct regular reviews and appraisals of the effectiveness of the company's governance, risk management, and internal control processes. The Listing Requirements (art.15.27) state a requirement of internal audit and of direct reporting by the internal audit unit to the audit committee. A Price Waterhouse/Bursa Malaysia survey (conducted before the latest Code update), reported that about 68 percent of listed companies responding to the survey had internal audit, and one-third of these had outsourced this function (APO 2007: 92-128).

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	Listed companies must meet Corporate Governance Code standard on internal audit on a comply or explain basis.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect “illegal acts” in the books and records of companies, including bribery and other forms of corruption.	1) and 2): Corporate Governance Code advises that internal auditors should follow standards set by the relevant professional body. IIA/IPPF requires vigilance for fraud.
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	Per Corporate Governance Code: 1) through 3): Internal audit to include basic review and assessment of internal controls. IIA/IPPF standards address fraud. 4) Internal auditor to report directly to audit committee.

B. Audit committee

The earlier version of the Code on Corporate Governance advised every company board to form an audit committee of at least three directors, a majority of whom is independent and chaired by an independent non-executive director. The committee should investigate any matter coming to its attention that raises questions of management integrity, possible conflict of interest or abuse by a significant or controlling shareholder (APO 2007: 104). The 2012 Code (Recommendations 5.1, 5.2) advises that the audit committee should ensure that financial statements comply with applicable financial reporting standards, and adopt policies and procedures to assess the suitability and independence of external auditors. On the latter point, audit committees are advised to set policies on non-audit services by the auditors, and to obtain written assurance from the auditors of their independence.

The Bursa Malaysia Listing Requirements reiterate the required establishment and composition of the audit committee for listed companies (arts.15.09-15.10), providing specifics on the extent of financial expertise required of the relevant committee member (to include membership in the Malaysian Institute of Accountants). It also affirms the committee's function of nominating external auditors (art.15.12). In addition, the committee is to have written terms of reference that include the following (arts.15.11-15.12):

- Review with the external auditor and report to the board on the audit plan, evaluation of internal controls, audit report, and assistance given by company staff to the auditor.
- Review and report to the board on whether the internal audit function is appropriately structured and resourced, the components and results of the internal audit program, and the quarterly results and year-end financial statements including any accounting policy changes, significant events, compliance with standards and laws, and concerns about conflicts of interest or appropriateness of the external auditor.

The listing rules also require companies to publish in the annual report a description of the audit committee's composition, terms of reference, and activities, and a similar section on internal audit (art.15.15). If the audit committee determines that a matter reported by it to the board of directors has not been resolved, resulting in a breach of the Listing Requirements, the committee must promptly report it to the Exchange (art.15.16). The rules also spell out the committee's right to investigate and have free access to information, external advice, and communication within the company (art.15.17). The audit committee is to undergo review by the board at least every three years to determine if it has fulfilled its terms of reference. Some listed companies also task the committee with approving the head of internal audit.[16]

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	1) and 2): Audit committee recommended by Code on Corporate Governance and required for listed companies by Listing Requirements. In each case, committee to be headed by and have a majority of independent directors, and include a financial expert.
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers, employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	1) and 2): Supervision of external and internal audit, accounting methods, internal controls, and compliance with laws and standards required by Listing Requirements – for listed companies only. 3) No requirement for audit committee to provide such guidance, though MACC Act 2009 (art.25), imposes a general duty to report bribery transactions. 4) Audit committee to address breaches of laws and standards with board. If failure to resolve them causes breach of Listing Requirements, committee to report this to Bursa Malaysia. 5) The Whistleblower Protection Act, 2010 requires companies and their officers to protect the confidentiality of such reports.

C. Internal control and compliance systems

The Companies Act (art.167A) requires the directors of a public company and its subsidiaries to have in place a system of internal controls to ensure that assets of the company are safeguarded against loss from unauthorized disposition, and that all transactions are properly authorized and recorded as necessary for accurate accounting. The penalties available for non-compliance are imprisonment for six months and a fine of MYR 10,000 (USD 3,000). The Listing Requirements (arts. 15.23-15.26) direct every listed company board to place in the annual report a statement about the status of its internal controls, after review by the external auditor.

The Code on Corporate Governance provides several recommendations on matters related to internal control. The board should (Recommendations 1.1-1.3):

- Clearly define functions to be reserved for the board and others to be delegated to management.
- Establish clear roles and responsibilities in discharging fiduciary and leadership functions.
- Formalize ethical standards through a code of conduct, and ensure compliance.

A key function is identifying principal risks and ensuring the implementation of appropriate mitigation measures. This means understanding, monitoring, and managing risks and ensuring a proper balance of risks and returns. It also includes reviewing the management information and internal control systems, and ensuring that there is sound reporting on internal controls and regulatory compliance (Recommendation 1.2, Commentary). The board should determine the company's level of risk tolerance and actively identify and assess the key risks to the company's assets. Periodic testing of the internal control procedures and processes must be conducted to ensure that the system is viable and robust (Recommendation 6.1 and Commentary).

In addition, the Listing Requirements make it mandatory for directors of publicly-listed companies to undergo specified training and obtain an accreditation. Training should be continuous, and is required to be disclosed in the annual report (art.15.08). Directors receive training on such matters as corporate governance, responsibilities and liabilities of directors, risk management, and the legal framework (APO 2007: 106). This is unusual, especially in the region, and may serve as a model for other countries trying to embed good corporate governance practices. On the other hand, it is reported that many listed companies do not disclose details of their code of ethics, whether the content or the means of implementation and monitoring (ADB 2013: 28-29). Since the Code requires companies to have ethics standards, it is appropriate to infer that companies who have complied would report it.

International standard	Compliance by member country
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees. 4) Risk-based approach: • Individualized assessment of risks to the enterprise, including corruption risks. • Regular monitoring and re-assessment of corruption risks.	1) Internal controls required of all companies per Companies Act, but disclosures on internal controls required only of listed companies per Listing Requirements. 2) External auditors of listed companies to review board disclosures on internal controls, per Listing Requirements. Code on Corporate Governance recommends testing of controls. 3) No such requirement, although Listing Requirements mandate director training. 4) Code details risk basis, assessment, and monitoring, but does not mention corruption.
Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements. 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations. 4) Require for third-party representatives, consultants, or agents: • Written contract, adherence to company ethics standards and	1) Legal compliance is a component of internal control per Code on Corporate Governance. 2) through 4): No legislated requirements, but companies that sign the Corporate Integrity Pledges and Integrity Pact agree to such requirements.

anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	
Enforcement, including sanctions for failure to comply.	Fines and imprisonment for violation.

4. Integrity of financial statements

A. Accounting

1. Financial records

The Companies Act (art.167) states the requirements for record-keeping. All companies, along with their officers and directors, are responsible for keeping sufficient accounting and other records to explain the transactions and financial position of the company, and enable true and fair financial statements to be prepared and audited. Entries must be made within 60 days of completing a transaction. The records must be kept for seven years, and if the records are outside the country, periodic returns (extracts or summaries) must be sent to Malaysia that enable accurate accounting and audit. The companies and the officers involved are subject to sanctions.

The Companies Act (arts.364, 364A) also deals with false statements in company documents. It prohibits knowingly making (or authorizing) any statement that is false or misleading in any material particular in a document (e.g. report, balance sheet) required for purposes of the Act. Authorizing a statement includes voting in favor of it at a meeting. Corporate officers are prohibited from providing any false or misleading information, with the intent to deceive, to directors, auditors, creditors, a stock exchange, or the Securities Commission. Violations are punishable by fines and imprisonment.

International standard	Compliance by member country
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	Form, manner, and place of company record-keeping regulated by Companies Act – including 7-year retention period.
Prohibitions (UNCAC 12(3), OECD Convention 8(1), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	1) Prohibition of knowingly making statements in company documents, or providing information to stakeholders or regulators, that is false or misleading, per Companies Act. Fines and prison terms apply. 2) Securities Commission Act 1993 art. 165 and Capital Market & Services Act 2007 prohibits the destruction of documents or records. 3) through 6): are prohibited by art. 303, Companies Act, and art. 114 of the Income Tax Act.[17]

2. Financial reporting requirements

Under the Companies Act (art.169), every company must submit audited financial statements (including profit and loss account, balance sheet and directors' report) to the shareholders. The financial statements are to be presented as a resolution of the directors and signed by at least two of them. These statements must be prepared according to approved standards issued by the Malaysian Accounting Standards Board (MASB), which is empowered to set standards under Section 7 of the Financial Reporting Act (1997).[18] Audited financial statements are to be filed with the Registrar of Companies except in the case of smaller private “exempt” companies. The latter must simply add to their annual returns a signed attestation of the accuracy and proper preparation of the statements.[19]

MASB has adopted the IFRS – in 2011 it issued the Malaysian Financial Reporting Standards (MFRSs), which are in word-for-word agreement with all IFRSs in effect as of 1 January 2012. Moreover, MASB’s plan is to maintain the identity of MFRSs and IFRSs going forward by adopting all new or amended IFRSs. Public companies are required by law to apply the MFRS/IFRS (with the exception of certain ‘transition’ entities). Private entities are permitted to use the MFRS or may use the Private Entity Reporting Standards (PERS) issued in prior years by the MASB. Under MASB guidelines, an entity that is a subsidiary, affiliate, or joint venture whose parent/investor is required to prepare full MFRS financial statements must itself prepare full MFRS financial statements. MASB is reviewing the IFRS for SMEs as a draft to be considered for adoption.[20] Publicly-listed companies and financial institutions are subject to the additional requirements of their regulators. BNM applies Guidelines on Financial Reporting for Banking Institutions and equivalent standards for Licensed Islamic Banks, while the Securities Commission's Financial and Corporate Surveillance Department ensures that listed firms comply with MFRS in the stock exchange context (World Bank 2012: 25-26).

The MFRS incorporate IAS 37 on material contingent liabilities, but there are additional requirements in this area imposed by the Companies Act (art.169). The directors' report to be included in the audited financial statements must detail any contingent liabilities arising after the end of the financial year or likely to become enforceable in the year following. The report must also include other circumstances not addressed in the statements, such as unusual situations or events, which would make the accounts or statements in any way misleading or affect the company's ability to meet its obligations. Where possible, the liabilities or misstatements must be quantified or estimated.

International standard	**Compliance by member country**
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) Public companies required to comply with IFRS/MFRS. 2) Private companies may use MFRS or tailored private company standards – PERS. Adoption of IFRS for SMEs under consideration. 3) Disclosure of off-balance sheet items required by MFRS/IFRS 10.
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) Disclosure of material contingent liabilities required per IAS 37, with additional detail specified in Companies Act. It is not clear whether disclosure of possible corruption liability would be material, hence required. 2) No explicit prohibition.

B. Audit

1. Auditing requirements

The Companies Act (arts.169, 172), requires all companies to perform annual audits of their financial statements. All shareholders have the right to a copy of the audited financials (art.170). The Act (art.174) spells out the auditor's duties and powers. Auditors are to report to the shareholders on the accounts, and on consolidated accounts as required for holding companies. The auditor must provide an opinion on whether the accounts have been prepared so as to give a true and fair view of the company's affairs and in accordance with approved accounting standards, whether the accounting source documents have been properly kept, and whether she/he has obtained all the information and explanations demanded. The audit report must provide the particulars of any deficiency in the above areas. The auditor has a right of access to the accounting and other records (including registers) of the company, and is entitled to require any necessary information and explanations.

The responsibilities of directors and officers with respect to audit are spelled out in several enactments. Under the Companies Act (art. 174), a company officer who fails to cooperate with the auditor, provide access to records or information demanded, or who otherwise obstructs the performance of the audit is subject to fines and imprisonment. The Act (art.169) requires at least two director signatures on the audited financial statements, and the Listing Requirements (art.15.26) mandate a statement, in the annual report, of the board's responsibility for preparing the annual audited financial statements. In addition, the Capital Markets and Services Amendment Act (2010) empowered the Securities Commission to prosecute directors and officers of listed corporations for causing wrongful loss to a company, and to prosecute anyone who coerces or influences the person responsible for preparing the financial statements of listed corporations, causing them to be materially misstated (art. 317A, 320A). Violations are subject to fines and imprisonment (World Bank 2012: 11).

Malaysia has fully adopted the ISA as the applicable audit standards, effective at the beginning of 2010. Standards are set by the Auditing and Assurance Standards Board (AASB), a functionally independent standard-setting body operating under the authority of the Malaysian Institute of Accountants (MIA). The AASB has an established procedure for vetting and adopting standards and technical pronouncements issued by the IAASB.[21] Further, the Audit Oversight Board (AOB) was established under the Securities Commission to oversee auditors of public companies, and in doing so to promote investor confidence in the quality and reliability of audited financial statements. A similar function is carried out by a separate professional body, the Malaysian Institute of Certified Public Accountants (MICPA). MICPA reviews published financial statements of listed entities audited by its members to ensure compliance with standards. The Institute is also conducting a review of financial statements of non-public listed entities audited by MICPA members.[22]

There is concern over auditors' workload and its impact on audit quality in respect of smaller private companies. All public and private companies have a mandatory statutory audit requirement regardless of their size and ownership structure, or whether they are actively operating. Without statutory exemptions, the number of audits required relative to the number of available auditors is very high. In 2008 the Companies Commission of Malaysia published a study recommending that SMEs should be eligible for exemption from the statutory audit requirement, and providing criteria for such determinations. Partly as a result of the blanket audit requirement, the World Bank expressed concern that audit quality might be below acceptable standards for private company audits, with competition keeping audit fees low and attracting the best skilled professionals to the largest accounting firms (focused on public companies) (World Bank 2012: 3-14). The Companies Act (art.169A) does provide for "Relief from requirements as to form and content of accounts and reports," permitting the Registrar to exempt companies upon application by their directors. There is a current move to exempt private companies in Malaysia from the annual audit requirement, but this has not yet been implemented.[23] As mentioned above, the Act (arts.4, 165A) exempts smaller private companies from the duty of filing annual audited financial statements with the Registrar.

As for audits of larger and listed companies, Malaysia's full adoption of the ISA, the oversight exercised by AASB and AOB, and more stringent provisions in the Companies Act and Listing Rules provide greater assurance that audit quality is maintained. An earlier review (APO 2007: 120-123) expressed concern that company boards had too much discretion in financial reporting, while keen competition among audit firms tended to weaken the rigor of external audits. Improved audit standards and quality control appear to have addressed these concerns.

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	Audit controls appear sufficient, though there are concerns over the quality of audit for non-listed, especially smaller private companies.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	1) All companies to perform annual audit and publish audited financial statements, per Companies Act. 2) No modified requirements for SMEs, though Registrar is empowered to provide exemptions from the annual audit requirement and the rules on form and content of accounts and reports.
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	Malaysia has fully adopted ISA including 240 and 250.
Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks. 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	1) Per Companies Act, auditor to certify accuracy/fairness of accounts, and provide opinion on financial statement preparation and company cooperation on audit. External auditors of listed companies to review board disclosures on internal controls, per Listing Requirements. Code on Corporate Governance recommends testing of controls. 2) Per Companies Act, two directors to sign audited financial statements, and failure to facilitate audit is subject to fines and imprisonment. Per Listing Requirements, directors' statement of responsibility for financial statements to be included with audited financials. Capital Market & Services Act Amendment 2010 empowers Securities Commission to prosecute directors or officers falsifying information or manipulating audit.

2. Auditor reporting of improprieties

The Companies Act provides for the external auditor's reporting to the authorities of matters including fraud discovered during the audit. Art.174(8) requires an auditor to report non-compliance with any provisions of the Act to the Registrar if the violation cannot be addressed adequately by comment in the audit report or by bringing the matter up with the company directors. In the case of a public company audit (or the audit of a company controlled by a public company), the auditor must report to the Registrar any "serious offence involving fraud or dishonesty" by corporate officers (art.174(8A)). Failure to report in either case is subject to fines and imprisonment. The Act provides a safe harbor provision to protect the auditor from liability (art.174(8B)), stating that no duty is contravened by the auditor's having reported the serious offense to the Registrar in good faith.[24] A further duty to report problems appears in art.172A of the Act, requiring an auditor who resigns to submit written representations or explanations to the Registrar, or to the Exchange in the case of a listed company. Lastly, the Anti-Money Laundering and Anti-Terrorism Financing Act 2001 (art.2(1)) requires accountants and company secretaries to report suspicious transactions to the FIU and BNM, the central bank.

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	Internal reporting of fraud or illegality required per ISA 240 and 250.
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").	Per Companies Act: 1) Auditor must report serious offenses of fraud or dishonesty to the Registrar, and provide written explanation if the auditor resigns. (Per AML/CFT law, Corporate secretaries and accountants to report suspicious transactions.) 2) There is no breach of duty when auditor reports serious offense of fraud or dishonesty to Registrar.

C. Professional standards and independence

The accountancy profession in Malaysia is governed by the Accountants Act, 1967, which provides for the establishment of MIA, the statutory body charged with regulating and developing the profession. With some 30,600 members, MIA oversees accounting education, quality assurance, and enforcement of professional standards.[25] MIA has in place an educational program accreditation process and an Ethics Standards Board, which applies the slightly modified Malaysian version of the IFAC/IESBA Code. MIA also has an investigation function that follows up formal complaints against members and applies MIA's Disciplinary Rules.[26] MICPA has equivalent disciplinary mechanisms for its members.[27] As mentioned above, AASB (operating under MIA), and AOB, established as part of the Securities Commission, set standards and oversee the performance of auditors.

The Companies Act provides for the appointment and independence of auditors. Companies appoint auditors at their annual general meeting, to hold office for the year, and can remove them only by resolution at the AGM. The Registrar is to receive notice of the removal or a copy of the auditor's written representations in response (art.172). The company must provide the shareholders a statement of all remuneration paid to the auditor (or members of the same audit firm) for non-audit services in the last financial year, if requested by 5% of shareholders or the holders of 5% of equity (art.173). Failure to comply is subject to fines. The Act (art.9) also includes a list of disqualifications for appointment as company auditor. These include:

- Not being an approved company auditor;
- Being indebted to the company or an affiliate; or
- Being an officer of the company, a business associate of a company officer or of her/his employee, or a shareholder of a company whose employee is an officer of the audited company.

A person or firm who accepts appointment as an auditor under such conditions is subject to fines. In addition, the MIA bylaws limit auditors of public companies to a maximum five-year term as key audit partner, with a two-year cooling-off period between terms (World Bank 2012: 16).

MIA and AOB conduct oversight of auditors. MIA selects member firms for review on a random basis in each review cycle. Firms whose quality of audit work was found to be unsatisfactory will be subject to a follow-up review. The AOB provides independent oversight of auditors on behalf of the Securities Commission. It registers individuals and firms that wish to audit the financial statements of public interest entities, inspects registered auditors to assess their compliance with auditing and ethical standards, and imposes discipline in cases of non-compliance. In addition, financial institutions must obtain prior approval from BNM on an annual basis for the appointment of statutory auditors.[28]

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) Qualification, licensing, oversight of accountants mainly exercised by MIA under Accountants Act. 2) MIA and MICPA follow IFAC (IESBA) Code.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	Per Companies Act: 1) Auditors appointed annually by AGM from qualified and permitted candidates. 2) Non-audit fees to be disclosed on shareholders' request. 3) Audit partner 5-year rotation with 2 years' cooling-off. 4) Conflict of interest rules apply but do not prohibit all interests. 5) No provision.
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) through 4): MIA sets qualification, registration, training requirements, and exercises oversight and discipline, for auditors. AOB fixes additional standards for auditors of public companies, also providing oversight and discipline. MIA independently authorized by Accountants Act, AOB by Securities Commission.

D. Enforcement

Enforcement provisions are mainly provided in the Companies Act, as follows:

- Form and retention of records: default brings fines of MYR 5,000 (USD 1,500) for guilty companies and officers, and imprisonment up to 6 months for officers (art.167).
- Accounts and financial reporting: a director who fails to comply or to secure company compliance with financial reporting provisions is subject to fines up to MYR 30,000 (USD 9,000), and acting willfully to prevent company compliance is subject to imprisonment up to 5 years in addition (art.171).
- Materially false or misleading statements: knowingly including such statements in company documents, or providing them to directors, auditors, or regulators is subject to imprisonment up to 10 years and fines of MYR 250,000 (USD 75,000)(arts.364, 364A).
- Cooperation with auditor: failure to cooperate with or obstructing an audit may result in imprisonment up to 2 years and fines up to MYR 30,000 (USD 9,000) (art.174).
- Auditor's duty to report non-compliance with Act: failure to do so is subject to imprisonment up to two years and fines of MYR 30,000 (USD 9,000) (art.174(8)).
- Auditor's duty to report serious offenses: failure is subject to imprisonment up to seven years and fines of MYR 250,000 (USD 75,000) (art.174(8A)).
- Auditor disqualifications: a person or firm accepting appointment in violation of these rules is subject to fines of MYR 30,000 (USD 9,000) (art.9).

According to monitoring data from the Companies Commission Malaysia, examples of breaches to the Companies Act include failure to submit audited accounts, of which there were 3,578 cases in 2010.

There are a few other legislative sources of sanctions. The Capital Markets and Services Amendment Act (arts. 317A, 320A) penalizes a director or officer who manipulates the preparers of financial statements, so that the statements are materially misstated, with imprisonment up to 10 years and fines up to MYR 10 million (USD 3 million). AOB can also impose sanctions on registered auditors for non-compliance with standards. The sanctions include a reprimand, prohibition on accepting new public company audit assignments, fines up to MYR 500,000 (USD 150,000), and suspension or revocation of the auditor's registration with AOB (WB 2012: 11-12).

The MIA is also responsible for surveillance and discipline of professionals auditing non-public interest entities. All member firms are selected for review on a random basis in a five-year review cycle (this may be difficult to achieve with the current shortage of staff). Since the MIA began conducting practice reviews in 2005, 34 percent of audit firms registered with the MIA have been subjected to a practice review. The basis of selection is random rather than risk based. Forty-eight percent of the audit firms reviewed were found to be deficient and were assessed as needing a follow-up review. The major area of weakness relates to documentation of audit procedures. In two instances recently, audit firms were referred for investigation as a result of these MIA reviews. The MIA has taken an approach aimed at improving the compliance of firms with auditing standards through education and training. But government and the profession acknowledge that enforcement and disciplinary actions must have a more central role in MIA's efforts in order to achieve a far higher level of compliance. One of the issues that will need to be addressed is that the MIA does not have the authority to suspend the registration of audit firms, but only of individual auditors, on a temporary basis. The MIA also conducts investigations in response to complaints.[29]

The Securities Commission has a market supervision section, which includes the Financial and Corporate Surveillance Department (FCSD). The mission of the FCSD is to ensure public listed companies comply with the substance and form of MFRS. It conducts proactive surveillance activities in order to pre-empt any noncompliance issues. Where necessary, it refers any adverse findings to the appropriate department or other regulatory authorities.[30] The FCSD in 2011 undertook a comprehensive review of corporate governance in all listed companies. In addition to these reviews, the FCSD's proactive surveillance activities include a number of triggering factors such as a qualified audit report, a referral from management, a change of auditor, and late submission of financial statements. The FCSD has taken some enforcement actions. Examples of enforcement actions include the rectification and re-issuance of financial statements, private or public reprimands and fines, as well as referrals to other departments of the Securities Commission and to other regulatory authorities.[31]

International standard	Compliance by member country
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1)). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2): Penalties can be severe, but most do not apply to companies. Enforcement powers appear largely appropriate. Professional discipline may need strengthening.
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) MIA disciplinary sanctions apply. Legal penalties include fines up to USD 3 million and 10 years imprisonment. 2) Some penalties apply to companies; most do not. 3) Enforcement mechanisms are in place that appear largely appropriate.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) MIA, AOB, and FCSD disciplinary sanctions apply. Legal penalties include fines up to USD 3 million and 10 years imprisonment along with professional reprimands and suspensions. 2) Some penalties apply to companies; most do not. 3) Enforcement mechanisms are in place that appear largely appropriate.

5. Conclusion and recommendations

A. General efforts to prevent corruption involving the private sector

Malaysia boasts an impressive array of transparency, anti-corruption, and corporate governance initiatives. These include research centers, integrity pacts, complaint mechanisms, and standard-setting initiatives. In regional terms, the civil service is thought to suffer relatively low corruption, but the latter remains a concern generally for government and the private sector.

Recommendations

1) Expand application of the Code on Corporate Governance beyond listed companies, eventually to all public corporations and at least the largest private companies.
2) Permit and facilitate anti-corruption and corporate governance initiatives that are less tied to government and driven to a greater extent by independent civic and private sector initiative.

B. Internal controls

Internal audit systems are required of listed companies and recommended for all companies. The Companies Act 1965 does require all companies to implement internal controls, without specifying internal audit as such. The Code on Corporate Governance recommends establishment of an audit committee according to good international practice, but this is a requirement only for listed companies. Audit committee standards do not specify the committee’s responsibility to provide anti-corruption guidance or the provision of confidential complaint and reporting channels. Importantly, Malaysia requires internal control systems of all companies, and backs this up with legal sanctions. Guidance on methods of control is provided through the Code. Only listed companies are required to meet detailed standards, including disclosure of internal controls in the company annual report and – an unusual and laudable addition – mandatory training for directors. The control provisions deal with risk of fraud but not other corruption risks.

Recommendations

1) Extend internal audit requirements to non-listed public companies.
2) Broaden audit committee requirement to non-listed public companies. Include in the committee's duties the provision of anti-corruption guidance and a confidential channel for reporting on integrity concerns.
3) Apply detailed internal control requirements to non-listed public companies, and incorporate guidance on bribery risks.

C. Integrity of financial statements

The Companies Act provides detailed accounting and audit requirements for all companies, with some more stringent rules applying to listed firms. The Act imposes a 7-year record retention period and applies fines and imprisonment to the intentional placement of false or misleading information in accounting documents. All companies must prepare and disseminate audited financial statements. Malaysia has fully adopted the IFRS and ISA, but has not yet adopted special standards or categorical exceptions in respect of SMEs. There are concerns that audits for such firms may be performed at low cost, thereby compromising audit quality. Critically, Malaysia requires auditors of public companies to report serious offenses to the authorities, and provides a safe harbor protecting the auditor from liability in such cases. Auditor appointment is subject to fairly robust safeguards, and potentially severe penalties apply to violations of financial reporting and audit regulations on both the corporate and the auditor side.

Recommendations

1) Outlaw off-the-books dealings and other methods that may be used to disguise corruption.
2) Adopt appropriate modifications of accounting and audit rules for SMEs, including full or partial exemption from audit requirements.
3) Strengthen oversight of private company audit, building on MICPA initiative.
4) Adopt legal provisions for company liability in cases of financial reporting and auditing violations.

Malaysian Laws, Regulations, Policy Documents Referenced:

Accountants Act, 1967[32]
Anti-Money Laundering and Anti-Terrorism Financing Act 2001
Banking and Financial Institutions Act of 1989
Bursa Malaysia Securities Berhad, *Main Market Listing Requirements*, www.bursamalaysia.com/ misc/system/assets/5957/regulation_rules_main_market_bm_main chapter15.pdf
Capital Markets and Services Act of 2007 and amendment in 2010
Companies Act of 1965 and amendments in 2007,
Financial Reporting Act of 1997
Income Tax Act 1967
Malaysian Anti-Corruption Commission Act, 2009
Malaysian Code on Corporate Governance of 2012
Securities Commission Act 1993 and amendments in 2011
Whistleblower Protection Act, 2010.

NOTES

1 http://data.worldbank.org/about/country-classifications/country-and-lending-groups#Upper_middle_income
2 http://www.bti-project.org/reports/country-reports/aso/mys/index.nc.
3 http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/malaysia/show-all.aspx, http://www.bti-project.org/reports/country-reports/aso/mys/index.nc.
4 http://cpi.transparency.org/cpi2013/results/#myAnchor1.
5 http://www.doingbusiness.org/data/exploreeconomies/malaysia.
6 http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/malaysia/show-all.aspx.
7 Government Circular on Disciplinary Action against Companies and Consultants No.6/2010.
8 http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/malaysia/show-all.aspx; ADB (2013), ASEAN Corporate Governance Scorecard, p.21-31; Malaysian Code on Corporate Governance, 2012, http://www.mia.org.my/new/downloads/circularsandresources/circulars/2012/21/MCCG_2012.pdf; government comments.
9 Government comments.
10 Government comments.
11 http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/malaysia/show-all.aspx.
12 MACC art.7; Treasury Circular Letter No.10 of 2010; UNODC (2012), *Implementation of article 12 of the United Nations Convention against Corruption, including the use of public-private partnerships*, CAC/COSP/WG.4/2012/2, p.12-13; ADB/OECD Anti-Corruption Initiative (2012), *Recent steps taken to implement the ADB/OECD Anti-*

Corruption Action Plan and United Nations Convention against Corruption (UNCAC): Country Reports, p. 82-86.

[13] http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/malaysia/show-all.aspx; Asian Productivity Organization (APO 2007), *Best Practices in Asian Corporate Governance*, p.121.

[14] The sources of all standards are provided in footnotes to the tables presented in the section of the Review entitled *International Standards for Country Reports.*

[15] Bursa Malaysia Securities Berhad, *Main Market Listing Requirements*, art.15.27, www.bursamalaysia.com/misc/system/assets/5957/regulation_rules_main_market_bm_mainchapter15.pdf.

[16] ADB (2013), *ASEAN Corporate Governance Scorecard*, p.28-9.

[17] As reported by government.

[18] Companies Act (art. 166A); World Bank (2012), *Report on the Observance of Standards and Codes (ROSC): Malaysia Accounting and Auditing*, p.9, http://www.worldbank.org/ifa/rosc_aa_malaysia2011.pdf.

[19] An exempt private company is a private limited company, the shares of which are not held directly or indirectly by any corporation and which has not more than 20 members. Companies Act arts.4, 165A. Government comments.

[20] http://www.ifrs.org/Use-around-the-world/Documents/Jurisdiction-profiles/Malaysia-IFRS-Profile.pdf.

[21] Action Plan Developed by Malaysian Institute of Accountants (MIA), p. 9, http://www.ifac.org/sites/default/files/compliance-assessment/part_3/201311%20Malaysia%20MIA.pdf.

[22] Action Plan Developed by the Malaysian Institute Of Certified Public Accountants (MICPA), p.3, http://www.ifac.org/sites/default/files/compliance-assessment/part_3/201312%20Malaysia%20MICPA.pdf.

[23] See Section 262 Companies Bill 2013 and also Norashikin Kamarudin, Zubaidah Zainal Abidin, Malcolm Smith, (2012) "Audit exemption among SMEs in Malaysia", Asian Review of Accounting, Vol. 20. No.2, pp.152 – 162; government comments.

[24] Under sub-section 8B(b), “serious offense” is defined as punishable by two years’ imprisonment or the value thereby gained or lost exceeding MYR 250,000 (USD 75,000).

[25] http://www.mia.org.my/new/about.asp.

[26] MIA Action Plan, pp.6-17, http://www.ifac.org/sites/default/files/compliance-assessment/part_3/201311%20Malaysia%20MIA.pdf.

[27] MICPA Action Plan, pp.5-14, http://www.ifac.org/sites/default/files/compliance-assessment/part_3/201312%20Malaysia%20MICPA.pdf.

[28] World Bank (2012: 11-26); MIA Action Plan, p.3, http://www.ifac.org/sites/default/files/compliance-assessment/part_3/201311%20Malaysia%20MIA.pdf.

[29] Government comments.

[30] The Capital Market and Services Act (2007) provides the legal foundation for this, especially art. 320 (3), which allows the Securities Commission to impose additional audit requirements.

[31] Government comments.

[32] This and other company-related legislation available at http://www.ssm.com.my/ and http://www.mia.org.my/new/circularandresources_related.asp.

Mongolia

1. Introduction

Mongolia is one of the fastest-growing economies in the world, with GDP growth well above 10% in recent years (17.5% in 2011)[1] and the poverty rate falling (to 28% in 2012). Driving the growth is a boom in the mining sector, a result of Mongolia's deposits of copper, gold, coking-coal, and uranium estimated at a combined value of more than USD 1.2 trillion. The country's location on China's border gives it privileged access to the world's largest commodity consumer, but also makes it heavily dependent on its neighbor. China accounts for over 90% of Mongolia's exports. Since the onset of its economic transition in 1990, Mongolia has promoted foreign trade and investment, achieving significant trade liberalization and boosting FDI inflows to some 44% of GDP in 2011 – largely in the extractive sectors. The financial sector has also attracted investment recently, with foreign institutions in 2012 buying stakes of some 5% each in Golomt Bank and Trade and Development Bank of Mongolia, respectively the second- and third-largest banks in the country. In the same year, a new foreign investment law was adopted, imposing new approval requirements for large (over USD 75 million) foreign investments in strategic sectors such as mining, banking, and the media. [2]

Mongolia is also a democracy and a committed reformer that has adopted massive changes in its governance and economic structures since 1990. The current National Development Strategy aims to transform the country into an export-oriented and knowledge-based economy by developing the strategic minerals sector, addressing urban-rural disparities and environmental impacts, consolidating democracy, and combating corruption. Elected political representatives have considerable power to govern. But most parliament members are also part of a business elite with tangible interests to protect. At the same time, government has taken steps to counteract corruption as a means of influence. Several high-profile cases were launched in 2012 and 2013. In one, the police arrested a former president on corruption charges brought by the Independent Authority Against Corruption (IAAC) – an event broadcast live on television. Subsequently, seven high officials were detained in connection with alleged corruption, money laundering and mismanagement of the national airline. Similar cases have been brought against several large conglomerates. President Elbegdorj Tsakhia has openly endorsed the fight against corruption and made it one of his main priorities.[3]

Mongolia's relative poverty, underdevelopment, and resource-dependence have caused it to fall behind in the modernization of some key market systems and institutions. The Global Competitiveness Report scores for the country's financial market development are lower than those for many post-socialist transition economies. Foreign investment is officially welcome, but a legislative framework facilitating investment continues to evolve while raising concerns among potential investors. As of 2009, capital markets were characterized as thin and relatively unsophisticated, with the Mongolian Stock Exchange (MSE) averaging only five new listings and nine de-listings per year between 2000 and 2008. Although stock market capitalization has grown, it was largely concentrated in the 20 largest Mongolian companies.[4]

2. General efforts to prevent corruption involving the private sector[5]

Mongolia's Anti-Corruption Law[6] devotes a chapter to IAAC's relations with the public, providing for its receipt of public complaints and charging it with duties to conduct public awareness and prevention activities. IAAC thus devotes significant efforts to awareness-raising and educational programs for the general public, including youth-oriented campaigns carried out in cooperation with international NGOs, citizen forums in all provinces and major cities to discuss prevention measures, and quarterly meetings with the NGO sector to coordinate joint activities. Mongolia is currently developing its National Program on Combating Corruption and Strengthening the National Framework of Integrity. This work is organized and supported by the Office of the President, IAAC, USAID, and others. A working group developed a draft of the Program and submitted it to the Mongolian Women Lawyers' Association to organize citizen forums and debates around Mongolia. Overall, 74 debates were held across the country with some 3160 participants, organized as follows: a) government, NGOs, private sector, and media; b) citizens and provincial and local officials; and c) members of the official working group and international experts provided by UNDP. The final draft of the document is expected to be introduced in the 2014 Spring Session of the Parliament.

There have also been outreach efforts in relation to private sector integrity and corporate governance. The Financial Regulatory Commission (FRC) approved the Mongolia Corporate Governance Code (MCGC) in 2007, and at about that time, the Bank of Mongolia (BOM) adopted a regulation on corporate governance in the banking sector. A series of events was convened to raise awareness of corporate governance in general and the MCGC in particular. Most of these initiatives were launched and led by international or bilateral donor agencies (World Bank 2009:7). The Corporate Governance Development Center[7] was established soon after, in order to carry out public awareness activities related to MCGC. The management board of the Center consists of 10 members from the private and public sectors, including one from the Financial Regulatory Commission. The "National Program for Development of Corporate Governance" was approved by Cabinet Resolution in 2011. The Financial Regulatory Commission is tasked with ensuring the timely implementation of the National Program, with support from the state budget as well as donor agencies.

The Anti-Corruption Law and Law on the Regulation of Public and Private Interests and Prevention of Conflict of Interest in Public Service do not provide for sentence mitigation as an inducement to self-reporting. The Criminal Code (arts.55 and 551) does allow reduction of sentences, but data show that these provisions are rarely used.[8]

International standard[9]	Compliance by member country
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	There is significant public-private cooperation in this area, mostly general in nature and mainly led by IAAC and the President with support from international donors.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) The Anti-Corruption Law requires IAAC to provide complaint channels – but these are not specific to business sector issues. 2) The Criminal Code provides for sentence mitigation, but this is little used in practice.
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) Private sector representatives have been included in public-private anti-corruption activities, but these do not appear to focus specifically on business-related corruption. 2) and 3): Roll-out of MCGC involved outreach by FRC to private sector, and subsequent establishment of Corporate Governance Development Center and related programs.
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	These do not appear to be used to any significant extent.

3. Internal controls

A. Internal audit

The Law on Accounting[10] (art.18) requires the management of a business organization to carry out internal audit. This may involve the appointment of an internal auditor, but the latter is not a requirement. An IFC study found that internal audit was performed in only 15% of companies reviewed. Most of the internal auditors did not report to the board or a committee of the board. The study found weak internal control policies, structures, and practices – and in only one case was it clear that the internal audit function reported findings from an independent review of the company's internal control processes, material controls, and risk management.[11]

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	It appears that companies do not have sufficient controls.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect "illegal acts" in the books and records of companies, including bribery and other forms of corruption.	1) and 2): There appears to be no organized internal audit profession, nor an association or an affiliate of IIA. Duties of internal auditors are not defined as such.
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	1) Internal audit required of all businesses. Content not defined, but should include basic audit components. Most companies do not carry out internal audit. 2) through 4): Not defined by law.

B. Audit committee

Companies have not until recently been required to have audit committees. The earlier Company Law of 2000 required joint stock companies to establish supervisory boards. This arrangement is not structurally the same as a board of directors with an audit committee, but it provides the supervisory board a similar role. Since audit committees were not required, the IFC study mentioned above found that they were not widely used (IFC 2013:71-72). At the time, Mongolia was in transition to the newly-adopted Company Law of 2011, which does require joint stock companies to establish audit committees. These committees are required to draw their chairmen and two-thirds of their membership from among independent company directors. The audit committees' scope includes ensuring compliance with accounting and record-keeping policies in line with international standards, overseeing internal controls and risk management, checking the accuracy of the financial reports and other information, nominating and contracting external auditors, and approving major transactions including those involving potential conflicts of interest (art.81).

Further, the Mongolia Corporate Governance Code[12] recommends that publicly listed companies should establish an audit committee of the board of directors to manage internal supervision. The committee membership should include at least three board members, with two-thirds of members (including the chair) being independent directors, and at least one member with professional accounting and finance experience (para.3.4.6). The rules and membership structure of the audit committee should be stated in the company charter. The committee should be an independent body chosen by the shareholders, and should monitor implementation of the corporate business plan, financial management, preparation of financial statements, and the effectiveness of internal supervision. It should have the authority to demand any necessary information, to assess the performance of company executives, and to suspend executives' authority if necessary. The committee should also be responsible for nominating the external auditor (paras. 7.1.3-7.1.9).

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	1) Audit committee requirement replaces supervisory board in Company Law 2011. 2) Company Law requires audit committee for JSCs. MCGC recommends them for listed companies. Committees to include independent directors as majority of membership (CL: 2/3 members and chair) and an accounting and finance expert (MCGC).
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers, employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	Per CL and MCGC: 1) Audit committee to oversee accounting and audit, and nominate external auditor. 2) Audit committee to monitor internal controls and performance of management. 3) Committee to approve major transactions, e.g. those with potential conflicts (CL). 4) to 5): No provision.

C. Internal control and compliance systems

In Mongolia, the need for internal codes of conduct, compliance, and controls is generally addressed in voluntary standards rather than law. However, the Anti-Corruption Law (arts. 6.5-6.6) requires private sector entities to “Define and comply with the norms of business ethics,” and to respond to IAAC resolutions directed at them by taking the necessary actions and reporting back in a timely manner.

The Corporate Governance Code addresses internal control issues (of listed companies) in several ways. First, it advises that the board of directors should monitor risk management and establish an “internal supervisory system” to monitor progress on the business plan, adherence to accounting rules, and financial performance (para.3.1.2). Second, the Code recommends inclusion in the annual report of any “Deviation of corporate governance practices from the ones recommended in this code, and reasons of failure to comply,” along with an action plan for corporate governance compliance in the coming year (paras.5.7.10-11). Third, an “internal supervision unit” is recommended to carry out the board's control functions. The unit should have operational rules and procedures spelled out in the company's charter or internal rules. Its main function is daily monitoring of company activities to ensure compliance with laws and standards, to detect and report any irregularities, and to provide advice and support to the audit committee. The unit should examine in particular any large corporate deals or any transactions that may involve conflicts of interest. It should report directly to the supervisory board and/or audit committee, and this should be specified in the company charter (paras.7.1.10-14).

The IFC study mentioned previously reports some findings relevant to internal control. First, disclosure of information is inadequate and in need of improvement, both for financial reporting and disclosure of non-financial information on matters such as company objectives, beneficial ownership structures, remuneration policies for board members, and corporate governance policies (IFC 2013:18). Second, there was little evidence of boards' articulation or publication of company values, or of performance evaluation of the board. The boards reviewed did not set a "tone at the top" regarding expected corporate behavioral standards and values, and very few had clear strategies in place (IFC 2013: 64).

International standard	Compliance by member country
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees. 4) Risk-based approach: • Individualized assessment of risks to the enterprise, including	1) MCGC recommends discussion of corporate governance and internal control problems and plans in company annual reports. 2) Internal supervision unit monitors financial reporting and reports to supervision board and/or audit committee. 3) No provision, little evidence of this in practice. 4) MCGC emphasizes board responsibility for risk management, but no explicit provision on corruption.

corruption risks. • Regular monitoring and re-assessment of corruption risks.	
Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements. 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations. 4) Require for third-party representatives, consultants, or agents: • Written contract, adherence to company ethics standards and anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	1) Anti-Corruption Law includes broad requirement for companies to codify and adhere to business ethics norms, and to comply with any relevant IAAC directives. 2) through 4): No explicit provision, though implied by Anti-Corruption Law and MCGC provisions on internal risk management.
Enforcement, including sanctions for failure to comply.	No provision.

4. Integrity of financial statements

A. Accounting

1. Financial records

The Company Law of 2011 (arts.95.1, 97.1) requires companies to keep several categories of documents including annual financial statements, bookkeeping and accounting records. (Bookkeeping and accounting records are not defined in more detail in the Law.) The documents are to be kept for five years (except the charter, which is to be kept indefinitely) at the place of business or other place accessible to the shareholders. After the retention period, the documents may be transferred to archives (art. 97.4). At that point, the documents fall within Mongolia’s Law on Archives, which governs storage and treatment from that point. The applicability of the latter instrument is stated in the Law on Accounting (art.14.1).

The Law on Accounting (art.20.1) also prohibits accountants from compiling false documents to fabricate transactions, destroying or damaging accounting documents or financial statements contrary to law, or correcting accounting documents or financial statements except by making adjustments as provided in the Law (art.8.4). It is a breach of the Law for an accountant to fail to maintain the required journals, general ledgers, and other primary accounting documents. Lastly, any transaction that does not have a primary accounting document may not be recorded in accounting records or financial statements (art.7.7).

International standard	Compliance by member country
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	Company Law, 2011 provides 5-year retention period before archiving.
Prohibitions (UNCAC 12(3), OECD Convention 8(1)), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	1) Accounting Law prohibits creating and using false documents. 2) Company Law and Accounting Law prohibit destruction contrary to their provisions. 3) and 4): No express prohibition. 5) Accounting Law: no recording without primary document. 6) Included generally within Accounting Law provision, but no express prohibition.

2. Financial reporting requirements

The Company Law (arts.95-98) requires companies to prepare financial statements according to relevant laws and the directives of the FRC and tax administration. Executive management is responsible for the reliability and correctness of the accounting books and financial statements of a company. Financial statements must include balance sheets and statements of profit and loss, cash flow, and accumulated earnings. The statements must also provide details of all conflict-of-interest and major transactions. Financial statements must be presented to the shareholders. In the case of a JSC, the financial statements must be submitted to the FRC and securities exchange, disclosed to the public, and provided to any stockholder along with reports of business operations.

The Accounting Law further requires the financial statements of all businesses to be based on accurate accounting records, to conform to international accounting standards, and to consist of a balance sheet, income statement, statement of changes in equity, and cash flow statement (arts.4.1, 8.1, 10.1, 10.2). The Law states that the business “may” publish audited financial statements (art.12). The Securities Law[13] clarifies this by requiring listed companies and other stock market participants to publish semi-annual audited financial statements (art.12).

The Accounting Law makes the Ministry of Finance responsible for developing, setting, and implementing accounting standards. The Ministry supervises the application of IFRS, for which purpose it issues guidance and interpretations, and holds workshops for accountants. The Mongolian Institute of Certified Public Accountants (MonICPA), the professional governing body, advises the Ministry on the adoption of IFRS – but MOF is the official standard-setter. Most reports of audits done by international auditing firms state that public companies are preparing their financial statement in conformity with IFRS. Most SMEs prepare financial statements under the Mongolian Accounting Regulation, not IFRS, as all non-listed companies are permitted to do by the Ministry (despite the Accounting Law’s requirement to use international standards). The IFRS for SMEs have not been adopted in Mongolia. The MOF is reported to be working on amendments to the Accounting Law that will include classification of business entities. The Ministry states that once the classification is established, it will propose legislation to adopt the IFRS for SMEs – an important step in light of the MOF’s estimate that there are approximately 70,000 businesses in Mongolia, of which 95% to 99% are SMEs.[14]

Under the Accounting Law, all for-profit and non-profit entities, including SMEs, SOEs and other entities, are required to prepare financial statements in full compliance with IFRS. While MOF is responsible for development of overall accounting and auditing policy, the Bank of Mongolia and Financial Regulatory Commission are responsible for issuing accounting regulations, consistent with IFRS, for banks and non-bank financial institutions. The accounting regulations issued by BOM and FRC have not been regularly updated and some clauses of the regulations have at times contradicted IFRS. Banks are required to publish their financial statements, which are to be submitted on a monthly, quarterly, and annual basis to BOM. The Securities Law requires listed companies to prepare and file semi-annual and audited annual financial statements to the Financial Regulatory Commission and the Mongolian Stock Exchange MSE). Listed companies are required to publish their financial statements in accordance with the FRC's format. The Securities Law is silent about the responsibility of the MSE to disclose financial information received from listed companies to the public, although the MSE voluntarily posts summarized financial information.[15]

The World Bank's 2009 report suggested that there were at the time a number of shortcomings in the implementation of financial reporting standards. A survey by the FRC showed that only 36% (138 out of 380) companies submitted the required financial statements in 2007. Compliance with IFRS was reported to be deficient, with few companies disclosing material information on their ownership and governance structures. The cost of preparing IFRS-compliant statements was reported to be an issue, particularly for SMEs. In practice, the published financial information, particularly for banks and listed companies, was summarized for publication without sufficient detail to make it very useful. Most companies prepared financial statements with the purpose of submitting them to the taxation office only, and therefore usually on a cash accounting basis. Although corporate groups are required under the Accounting Law to prepare consolidated financial statements, they usually did not. On the standard-setting side, MOF was reported to have insufficient resources to carry out fully its responsibilities for translating IFRS and developing IFRS-based national accounting standards and guidelines. Last, there was no central depository of public interest entities' financial statements for public access. All companies submit their financial statements to MOF, which has used them primarily for statistical analysis, but without making them public (World Bank 2009: 5-9, 17-19).

International standard	Compliance by member country
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) All companies to prepare financial statements per CL. All are required to use IFRS under Accounting Law, but many have not done so. 2) An alternative national standard can be used in practice by non-listed companies and SMEs. Mongolia plans to adopt IFRS for SMEs in future.[16] 3) Disclosures of affiliated companies required under Accounting Law, but compliance has not been consistent.[17]
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) Disclosure of contingent liabilities required in some cases by IAS 37, though this usually does not mean disclosure of potential corruption-related liabilities.[18] 2) Manipulation of records generally prohibited by Law on Accounting (see above), but no specific mention of corruption.

B. Audit

1. Auditing requirements

The Company Law (art.94) requires every joint stock company (JSC) to provide in its charter for appointment of an auditor to review and certify its annual financial statements, while for limited liability companies (LLCs), this is left as an option rather than a requirement. The board or shareholder meeting selects the auditor and approves the contract for her/his services. Officers of the company must provide any documents relevant to the company’s business activities and finances upon the auditor’s demand. The auditor’s report is to issue an opinion on whether or not the financial statements are correct and properly issued, the accounting books are in compliance with regulations (identifying any breaches), and conflict of interest transactions are in accordance with the Company Law. The audit firm is liable for damages caused by its audit conclusions. The MCGC (art.7.2.1) advises that an auditor should give an independent opinion on a company’s financial reports. The Law on Auditing (art.9.2) provides that the auditor’s report is to be certified by the head of the audit firm.

The Law on Auditing[19] (art.7.1) further defines the audit requirement, applying it to all companies listed on the MSE (and those in the process of obtaining a listing), financial sector and investment companies, any businesses with capital of MNT 50 million (USD 29,000[20]) or above, foreign-owned businesses (unless a treaty states otherwise), and those being restructured, liquidated, or auctioned. The Law requires all audits to follow international standards (while also stating that national standards are to "be approved by the competent authority in accordance with the principles of the international auditing standards," arts.8.1-8.2). Auditors are empowered under the Law to demand that the company provide any necessary documents and explanations, take physical inventory of any cash or other assets, request other businesses and financial institutions to provide documents for the audit, and to refuse audit services if the client does not cooperate (art.20.1). The Securities Law requires issuers (listed companies) to publish audited semi-annual and annual financial statements (art.12), and authorizes the regulator (the Securities Committee) to require issuers to have their financial statements audited by an independent auditor licensed by the Committee (art.20).

Under the Auditing Law, use of the ISA is mandatory. The version followed in Mongolia is that approved by IAASB in 2010, which has been in the process of comparison with the 2012 update for purposes of bringing the Mongolian translation of the ISAs up to date. The government has authorized the Mongolian Institute of Certified Public Accountants to translate accounting and audit standards. MonICPA has produced two audit manuals based on the ISA, and has been active in policy development and review of listed company, financial sector, and SOE audits under memoranda of understanding with the relevant authorities.[21] The World Bank (2008: 18) expressed concern about the time lag in adoption of new or revised ISA, due in large part to translation, suggesting that this hinders the development of audit practice in Mongolia.

The IFC (2013:54, 60-61) found implementation issues in its more recent study. Some 35% of the companies reviewed did not have a named, authorized independent auditor review their financial statements, or such audit was done but not according to current ISA. Although Mongolian companies generally do not provide an annual report, many of them do provide annual financial statements certified by the CEO and the Chief Accountant. Audit reports are usually not publicly available (only one company was found to have such a report accessible on its website), although some companies do file audit reports with their FRC filings.

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	Auditing controls are well-developed but do not appear fully sufficient for this purpose.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	1) and 2): All JSCs to have external audits per Company Law. Auditing and Securities Laws require listed and financial companies, and those surpassing capital threshold (USD 29,000) to be audited by licensed auditor and publish audited financial statements.
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	Mongolia has adopted ISA (2010 version, in process of update), including ISA 240 and 250. Adherence to ISA in practice appears uneven.
Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks. 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	1) Per Company and Auditing Laws: Audit requirements include use of ISA, and certification that accounts are accurate and appropriately prepared – but do not discuss testing of internal controls. Per MCGC: the auditor should give an independent opinion. Some companies file audit reports with FRC. 2) Companies often provide financial statements certified by CEO and Chief Accountant, though this is apparently not required. Corporate officers must cooperate with the auditor and provide full information. No explicit provision on misleading the auditor.

2. Auditor reporting of improprieties

Mongolia provides for internal reporting of irregularities and breaches of law, but not for reporting to public authorities. ISA 240 and 250 provide for internal reporting, and contemplate external reporting in limited circumstances. The Mongolia Corporate Governance Code (art.7.2.7), developed for listed companies, advises that independent auditors should reveal any breaches of the law by the company during their audit inspections. The auditors are to inform the board of directors and shareholders meeting, but not to disclose the information publicly. In effect, auditors reporting to the authorities are legally liable.

International standard	**Compliance by member country**
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	Internal reporting supported by ISA 240 and 250, and MCGC (listed companies).
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").	1) and 2): External reporting is contemplated in ISA 240 and 250, but not protected by any safe harbor provision and advised against by the MCGC.

C. Professional standards and independence

Various international analyses of corporate audit in Mongolia over the last several years express repeated doubts about the independence and professional objectivity of external auditors. Thus, the World Bank (2009:19) states: "Most external auditors do not appear to conduct their audits free from conflicts of interests, although the legal framework requires the external auditor to be independent." More recently, the IFC (2013:61) has found that "no company has in place a policy to review the external auditor's continuing independence in the light of other activities/non-audit services provided to the company in the areas of tax preparation, accounting support and consulting services. Therefore, external auditors may not be free from conflicts of interest." Further, the World Bank (2008:11) determined that the Law on Auditing did not provide effective limitations on audit firms performing non-auditing services. The Law (art.4.1) treats both audit services and non-auditing services as "auditing operations," which does not comply with ISA and other standards. "Therefore, many audit firms are currently in conflict of interest situations."

Auditors are in principle subject to several restrictions and to safeguards on their independence of judgment. The Law on Auditing (art.19.1) requires them to refuse engagements where actual or perceived conflicts of interest may occur. An auditor is not permitted to certify financial statements of a company where the auditor has been employed within the last two years, has had financial interests within the past year, or has relatives in any executive capacity. Auditors also may not work simultaneously for an audit firm and another such firm or in another full-time job (art.21.1). The auditing firm may not certify financial statements where it has investments or business contracts with the audited company, or has prepared its accounts or financial statements (art.29.1). The Company Law (art.94) prohibits an auditor from being affiliated with the audited company (e.g. as an employee or board member), holding securities or property rights in the company, or entering any transactions with the company apart from the audit agreement. Violation of this rule voids the audit opinion. Fees may not be made dependent on particular audit findings.

The Corporate Governance Code (art.7.2) provides some additional principles in this area, aimed at listed companies. Auditors are to be selected on the basis of independence and professionalism, and should not be affiliated with the company or shareholders. Safeguards of the auditor's objectivity should be written into the audit agreements. Auditors should attend shareholder meetings to answer questions about the audit findings, and should be legally responsible for damages to one who relies on an audit report and suffers losses because of negligent errors or omissions in the report – including the company itself and third parties.

Supervising compliance with the above standards, ensuring quality control, and governing the accounting and audit profession are responsibilities of MonICPA, acting under the authority of the Ministry of Finance. It is mandatory for CPAs and audit firms in Mongolia to become members of MonICPA, which applies the education and qualification standards of the Law on Auditing (art.12), and administers the CPA exam. From the first stage of the CPA program, individuals have 7 years to pass exams (in three stages), and are given lifetime CPA status upon completion – subject to meeting continuing education and other requirements. The Institute has developed standards on audit quality based on international norms, and offers training on audit and quality control standards, and on aspects of conducting audits. In collaboration with the National Audit Office and the FRC, MonICPA conducts training for firms performing audits of listed or other public interest entities and SOEs. MonICPA's Code of Ethics , adopted in 2012, is reported to be consistent with the IESBA Code of Ethics. MonICPA shares responsibility for investigation and discipline of members with the Ministry of Finance, and has three levels of sanction available: censure, suspension of audit license, and removal of CPA designation. MonICPA's investigation and disciplinary procedures are outlined in the Code of Ethics.[22]

According to the World Bank reports of a few years ago, this professional governance structure has not ensured effective and ethical audit practices in Mongolia. As of 2008-9, there was reported to be very little oversight of auditor quality in practice, and several instances were noted in which auditor independence was compromised by either the firm providing non-audit services or an individual in the audit firm being related to the audit clients. Reviews by the MOF were focused on compliance with laws and regulations rather than ISA compliance. No effective practice existed within MonICPA to ensure compliance with a code of ethics, and there were no sanctions or actions issued against auditors who failed to do so (World Bank 2008:11-14).

There are a couple of key reasons for this situation. One issue is that MonICPA depends for support on fees for membership, CPA exams, and training. Other professional associations exist, but are in the early stages of development. The MOF is not heavily involved, and thus there is no truly independent supervisor of the profession. A second issue is that the accounting and auditing profession is small compared to the number of enterprises subject to statutory audit – about 50,000 in 2008-9. For this work, there were 51 audit firms licensed by MOF to conduct statutory audits, and a total of 1,718 CPAs in Mongolia. The small supply of auditors and audit firms caused companies difficulty in complying with a three-year rotation rule (with three-year cooling-off) that had recently been incorporated into the Law on Auditing. The World Bank also found that most small audit firms certified financial statements by simply applying a stamp without really conducting an audit. An aggravating factor here was the seven-year training program for CPAs, as compared to three years in most industrial countries (World Bank 2008:11-14; World Bank 2009:19).

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) CPAs must complete 7-year program for full qualification. Licensing by MOF, oversight by MonICPA. 2) MonICPA has adopted the IFAC/IESBA Code, though implementation appears uneven.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	Per Company and Auditing Laws, MCGC: 1) Auditor appointed by board or AGM from licensed auditors and firms. 2) Restrictions on non-audit work apply, but appear not to be enforced. 3) Audit firm rotation every 3 years required. 4) Auditor financial interests and affiliation with audited company prohibited. Enforcement is in question. 5) No restriction.
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) MOF controls licensing. MonICPA examines and admits CPAs. 2) MonICPA applies ethical and training standards. 3) MonICPA is a professional body dependent on fees from members. MOF has authority but does not play a major role in governing the profession. 4) MonICPA has a structure for oversight and discipline, but these do not appear to be effective.

D. Enforcement

The Securities, Accounting, Auditing, and Company Laws provide for enforcement of the rules in this area. The Securities Law (arts.24-25) provides for inspectors to monitor and investigate compliance with its rules, including art.12 requiring listed companies to publish semi-annual audited financial statements. Failure to comply is subject to fines up to MNT 50,000 (USD 29) for individuals and up to MNT 200,000 (USD 115) for companies – in addition to confiscation of any income unlawfully gained as a result. The Law on Accounting (art.23) provides for fines up to MNT 60,000 (USD 35) for individuals and MNT 250,000 (USD 144) for companies in violation of the act – unless criminal penalties apply.

The Law on Auditing fixes sanctions for auditors and corporations that fail to comply with its provisions. As mentioned, MonICPA, on behalf of MOF, can impose warnings, suspension or termination of license, or expulsion from the profession on auditors who violate the law or the professional codes (art.22). Violation of technical or conflict-of-interest provisions, or causing losses due to audit errors, is subject to fines of up to MNT 50,000 (USD 29) for auditors and up to MNT 250,000 (USD 144) for audit firms – in addition to the firm's reimbursement of the loss to clients and other parties relying on the audited financial statements (art.31.1). Similar fines – where criminal sanctions do not apply – can be imposed on companies (up to MNT 250,000 or USD 144) and company officers (up to MNT 40,000 or USD 23) for failure to conduct an external audit as required, for impeding the auditor, or for refusing to provide accounting data for an audit of a related firm (arts.32.1, 33.1). Unlicensed audit practice by an individual or firm is subject to confiscation of the income earned thereby, and fines up to MNT 250,000 (USD 144).

Certain violations of the Company Law may result in criminal prosecution. In other cases, the Law provides for administrative sanctions (art.100). For example, failure to submit or disseminate financial statements according to the Law is subject to fines up to 15 times the minimum wage[23] for company directors, and in the case of a JSC, up to 40 times the minimum wage for the company itself. A company director (unless dissenting) and an owner of a 20% shareholding (in a JSC) are liable to damages for the company's breach of laws, regulations, and charter provisions. Shareholders are entitled to sue the directors for damage thereby caused to the company (art.84).

International standard	Compliance by member country
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2): Enforcement provisions and application in practice appear not to be robust or effective.
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) through 3): Apart from criminal penalties, maximum sanctions for both firms and individuals are quite low – fines are generally less than USD 150. Damages and confiscation or reimbursement of income from improper practices are available and could be effective if enforced rigorously. This does not appear to be the case. Penalties apply to individual accountants, company officials, and companies subject to financial reporting.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) through 3): Apart from criminal penalties, maximum sanctions for both firms and individuals are quite low – fines are generally less than USD 150. Damages and confiscation or reimbursement of income from improper practices are available and could be effective if enforced rigorously. This does not appear to be the case. Penalties apply to individual auditors, company officials, audit firms, and companies subject to reporting and audit.

5. Conclusion and recommendations

A. General efforts to prevent corruption involving the private sector

The Government of Mongolia has put substantial effort into public outreach on anti-corruption matters. Numerous participatory and awareness-raising events for a variety of constituencies have been held by the Independent Authority Against Corruption along with NGOs and the international community, notably in the context of the National Program on Combating Corruption. IAAC is required by law to provide channels for corruption complaints by the public. It does not, however, have authority to offer sentence mitigation to offenders who self-report, and this does not appear to be a significant part of the anti-corruption effort. Anti-corruption events, campaigns, and messages have not focused on corruption involving the private sector, although business representatives do appear to be included among the participants. A more focused public-private sector collaboration took place with the launch of the Corporate Governance Code, with multiple public-private events and efforts to institutionalize it. Integrity pacts, by which businesses in a given sector commit to anti-corruption principles and police themselves, are not in evidence.

Recommendations

1) Broaden government engagement with the business community on anti-corruption issues, especially those related to financial integrity, disclosure, and corporate governance.
2) Support integrity pacts in the private sector, perhaps focused on public procurement or contracting in the extractive industries. In addition to refraining from bribery, companies could pledge to meet international best practice standards on auditing and internal control systems to combat corruption.

B. Internal controls

This is an area in need of further development and strengthening. Internal audit in some form is required for companies, though the law does not specify how the function is to be performed. There is no organized internal audit profession. Mongolia’s corporate sector has been in transition from the supervisory board model under the former law to an audit committee structure included in the new law. Audit committees are not yet widely used. Nor have supervisory boards been optimally established to monitor company operations, corruption vulnerabilities, or risk management more generally. Internal codes, controls, and compliance mechanisms are not well defined in the laws and regulations, although the MCGC does provide for control through an internal supervision unit. The Anti-Corruption Law also requires companies to articulate and follow codes of business ethics. None of these standards has been followed consistently in practice.

Recommendations

1) Consider requiring formal internal audit units for listed companies, and perhaps other public interest entities. Support the development of an internal audit profession.
2) Support exchanges and training to enhance knowledge of audit committee practices internationally, and to expand the effective establishment and use of audit committees. Provide incentives for their adoption, e.g. regulatory norms of FRC and Securities Commission tied to compliance with audit committee requirement.
3) Phase in legal requirement of internal control system / internal supervision unit based on MCGC, for listed companies and eventually other public interest entities. Require reporting on internal controls in company annual reports, and include corruption prevention measures in the controls.

C. Integrity of financial statements

Mongolia has moved to adopt international standards, but has fallen short on implementation and enforcement. Protections against falsification of accounting records are in place, along with a 5-year retention period followed by archiving. All companies are required by law to produce financial statements according to IFRS, but this standard appears to be relaxed in practice for non-listed companies. Mongolia's intended adoption of IFRS for SMEs should help to resolve this anomaly. Other difficulties affecting financial reports include BOM and FRC reporting standards that lag behind current IFRS, limited capacity by MOF and MonICPA to enforce the standards, and insufficient published financial reporting information – which is usually made public in summary format. Audits (and publication of audited financials) are required of listed companies, financial and investment companies, those surpassing a capital threshold, and some others. Audits are to be done according to ISA, though the law refers to national standards that are based on, rather than fully convergent with, ISA. Auditors are not protected if they report fraud or corruption to public authorities, and corporate governance standards advise against their doing so. The main difficulty for financial reporting and auditing in Mongolia is weak implementation. Qualified CPAs are too few (in part due to onerous education requirements), translation of standards into Mongolian is slow, insufficient capacity exists for rigorous enforcement of auditor conflict-of-interest and other standards, and the legal penalties for the most part are quite weak.

Recommendations

1) Consider alternative approaches that would speed up translation and implementation of international standards by all the relevant entities and professionals. This could perhaps include educational programs to train personnel to translate and issue standards, making more use of other versions such as the Russian or Korean, or legislating a calendar of updates and revisions that is less onerous than keeping current on all standards. IFRS for SMEs should also be adopted and implemented as a priority, and regulators should update standards in coordinated fashion.
2) Phase in requirement (and enforcement) of more detailed financial statements and full publication, to improve access to quality information on companies. Establish a central repository or server for access to audited financials of all companies required to publish them.
3) Increase the numbers of CPAs by restructuring the qualifying educational program and exams so that the full CPA credential can be completed in less than 7 years and closer to 3 years. Consider lightening regulations or improving incentives for foreign CPAs and international audit firms to locate in Mongolia.
4) Move toward a requirement for auditors to report fraud and corruption discovered in the course of an audit to public authorities, and a safe harbor provision protecting the auditors from liability.
5) Strengthen enforcement of the laws on financial reporting, audit, disclosure, and corporate governance. Increase fines and index them for inflation. Consider moving the relevant MonICPA and MOF functions into an expert independent agency funded by both government and professional taxes or fees.

Mongolia Laws, Regulations, Policy Documents Referenced:

Company Law of Mongolia, 2000, http://www.track.unodc.org/LegalLibrary/pages/LegalResources.aspx?country=Mongolia.

Company Law of Mongolia, 2011.

Corporate Governance Code of Mongolia, Financial Regulatory Commission 2007, http://www.ecgi.org/codes/documents/mongolia_code_2007_en.pdf

Law of Mongolia on Accounting, 1993 (as amended), http://www.asianlii.org/mn/legis/laws/al2002130/.

Law of Mongolia on Anti-Corruption, 2006 (amended 2008), http://www.track.unodc.org/LegalLibrary/pages/LegalResources.aspx?country=Mongolia

Law of Mongolia on Archives, 1998.

Law of Mongolia on Auditing, 1997 (as amended), http://www.track.unodc.org/LegalLibrary/pages/LegalResources.aspx?country=Mongolia.

Securities Law of Mongolia, 1995, http://www.asianlii.org/mn/legis/laws/sl1995151/.

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[1] http://data.worldbank.org/country/mongolia.

[2] BTI (2014), *Mongolia Country Report*, Bertelsmann Stiftung, http://www.bti-project.org/reports/country-reports/pse/mng/index.nc.

[3] BTI (2014).

[4] BTI (2014); World Bank (2009), Report on the Observance of Standards and Codes (ROSC) : Corporate Governance Country Assessment – Mongolia, pp.5-6, http://www.worldbank.org/ifa/rosc_cg_mongolia_09.pdf.

[5] Except where otherwise indicated, the material in this section is drawn from government questionnaire responses.

[6] Law of Mongolia on Anti-Corruption, 2006 (amended 2008), Ch.II, arts.5, 6, 9, http://www.track.unodc.org/LegalLibrary/pages/LegalResources.aspx?country=Mongolia.

[7] http://www.cgdc.org.mn.

[8] Government comments.

[9] The sources of all standards are provided in footnotes to the tables presented in the section of the Review entitled *International Standards for Country Reports.*

[10] Law of Mongolia on Accounting, 1993 (as amended), http://www.asianlii.org/mn/legis/laws/al2002130/.

[11] IFC (2013) Corporate Governance Scorecard 2011, p.73, http://www.ifc.org/wps/wcm/connect/2497ac00420dd6e7a00bff494779b2ad/Mongolia_Scorecard_2013_ENG.pdf?MOD=AJPERES.

[12] Corporate Governance Code of Mongolia, Financial Regulatory Commission 2007, http://www.ecgi.org/codes/documents/mongolia_code_2007_en.pdf.

[13] Securities Law of Mongolia, 1995, http://www.asianlii.org/mn/legis/laws/sl1995151/.

[14] http://www.ifrs.org/Use-around-the-world/Documents/Jurisdiction-profiles/Mongolia-IFRS-Profile.pdf.

[15] World Bank (2008), Report on the Observance of Standards and Codes (ROSC): Mongolia Accounting and Auditing, pp. 6-7, http://www.worldbank.org/ifa/rosc_aa_mongolia.pdf.

[16] IFRS for SMEs is included in the draft Law on Accounting submitted to Parliament in April 2014; government comments.

[17] The 116th Ordinance of Minister of Finance of 2000 on "List of accounts to be complied in the transactions of business entities and exemplary instruction of accounts" is to be amended in 2014 and will address the issue of off-balance sheet transactions and special-purpose entities; government comments.

[18] Disclosure of contingent liabilities by companies is stipulated in the "Instructions for preparing financial report and disclosure" of 77th Ordinance of Minister of Finance of 2012 (Appendix 1); government comments.

[19] Law of Mongolia on Auditing, 1997 (as amended), http://www.track.unodc.org/LegalLibrary/pages/LegalResources.aspx?country=Mongolia.

[20] All currency conversions at interbank rate as of Mar.5, 2014, http://www.oanda.com/currency/converter/.

[21] Action Plan developed by the Mongolian Institute of Certified Public Accountants, p.9, http://www.ifac.org/sites/default/files/compliance-assessment/part_3/201309%20Mongolia%20MonICPA.pdf

[22] MonICPA Action Plan, pp.3, 6, 12, 15, http://www.ifac.org/sites/default/files/compliance-assessment/part_3/201309%20Mongolia%20MonICPA.pdf.

[23] The Law does not state whether this is the daily, monthly, or annual minimum wage.

Nepal

1. Introduction

The political situation in Nepal has been extremely volatile during the past several years, during which the country has gone through an uneasy transition often characterized by violent power struggles between the King, political parties and Maoist insurgents. Economic growth is uneven, with instability stalling growth and divides of caste, religion, and ethnicity making the settling of political differences and policy decisions difficult. Nepal continues to be very poor (per capital GDP at USD 700 [1]), with households heavily dependent on external remittances, officially comprising some 23% of GDP. On the other hand, a fragile negotiated peace is holding while the constitution and armed forces are restructured, elections are held, and governments (albeit slowly) formed. In addition, poverty is steadily decreasing. [2]

The business sector reflects the difficulty and instability of overall governance in Nepal. Political parties continuously dispense patronage to members and supporters, both in terms of material resources and administrative favors. The business community has adapted to this, as companies have learned to work through the system, and some indeed to profit from it. Legislation to prevent monopolies and cartels exists, but it is scarcely implemented. In fact, informal access barriers, collusion and price fixing are part and parcel of regular business conduct across a wide range of sectors, and are routinely tolerated by regulators. Partly as a result of such influences formally registered enterprises in Nepal are estimated to comprise as little as one-fifth the total, and the percentage of workers employed informally as much as 70% of the work force (BTI 2014).

Corruption is recognized as a fundamental problem in Nepal. It continues to be so despite the many steps Nepal has taken to address it such as the Prevention of Corruption Act 2002, ratification of UNCAC (signed 2003, ratified 2011), empowering the Commission for the Investigation of Abuse of Authority (CIAA) to investigate financial irregularities and public sector corruption under the 2007 Constitution, and adopting a national anti-corruption strategy in 2009. These measures are in general poorly enforced, and in practice sanctions are applied mainly to low-level public officials, with a minimal impact on the top political and business figures. Yet, the Supreme Court in 2011 sentenced a former government minister to 18 months imprisonment for corruption – reported to be the first conviction at this level since Nepal's transition to democracy in 1990.[3]

This situation poses numerous risks for business operations and corporate governance. Business surveys in 2011 indicated that the costs of petty crime, violence, terrorism and organized crime imposed on companies are high. The same surveys showed that the ethical standards of companies operating in Nepal in their interactions with public officials, politicians, and other companies are low and present a competitive investment disadvantage. In 2012, the Financial Action Task Force (FATF) placed Nepal on its high-risk "grey list," finding that corruption, the circulation of counterfeit money, and tax evasion, have all risen due to the lack of regulatory implementation. Business executives surveyed in 2009 ranked corruption as the second most problematic factor for doing business in the country, exceeded only by government instability. There is reported to be significant official favoritism towards well-connected companies, along with entrenched practices of inflating project costs and the valuations of securities. Officially blacklisted company owners are known to register new corporations and thereby continue to bid for state contracts unimpeded. At the same time, foreign investment in financial, legal and accounting services is restricted by law, making it difficult for foreign investors to seek help cutting through regulatory red tape.[4]

2. General efforts to prevent corruption involving the private sector

The Prevention of Corruption Act 2002 criminalizes attempted corruption, active and passive bribery, money laundering, and fraud, and establishes the legal framework for the Commission for the Investigation of Abuse of Authority. A framework for fair dealing and integrity in the private sector is provided in the Competition Promotion and Market Protection Act 2006. This Act prohibits anti-competitive practices such as tied selling, bid rigging, cartel formation, collective price fixing, undue business influence, as well as syndicate and exclusive dealing. The CIAA's mandate also includes private sector-related issues such as active bribery, financial crime, and the review of regulatory systems. As noted above, the enforcement of both of these frameworks, and especially the latter, has been uneven at best.[5]

In this situation, official outreach to the public and the efforts of the private and civic sectors take on added importance. The first method here is to provide channels for complaints, whistle-blowing, and self-reporting of offenses. The CIAA receives complaints by telephone, hotline, e-mail, and on its website, and promises confidentiality. Complaints may also be made to the National Vigilance Center (NVC). The Prevention of Corruption Act addresses the protection of informers, but the relevant provisions appear to some analysts as being designed to discourage false reporting rather than to encourage and protect accurate reporting. It is also reported that the authorities in Nepal may provide financial rewards and/or immunity from prosecution to informants including those who confess to active bribery. [6]

Civic engagement draws on the capacities of a non-governmental sector widely acknowledged as one of the great strengths of Nepal's society. Thus, the CIAA has developed programs that engage civil society organizations in monitoring the work of government offices. Local coordination forums bring together representatives of government line agencies, the business community, and civil society organizations to conduct awareness-raising programs and training, and to play a role in reporting corruption cases. The Federation of Nepalese Chambers of Commerce and Industry (FNCCI) has carried out the first major initiatives to target business-related corruption in Nepal. The FNCCI has, in collaboration with the Government of Nepal, civil society and other stakeholders, implemented a range of measures, including an awareness-raising campaign, a business code of conduct, and the Corporate Ethics Forum to reduce corruption.[7]

International standard[8]	Compliance by member country
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	Civic engagement initiatives to combat corruption are of long standing, while public-private and private-sector based programs are in an early phase of development.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) Channels for complaints and reporting provided by CIAA and CVC. 2) Immunity, mitigation, rewards are reportedly used for informants including self-reporting bribe-givers.
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) Some government outreach to civic and business sectors on this. 2) CIAA and FNCCI are involved in awareness-raising. 3) FNCCI has published an ethics code and set up a forum for business sector anti-corruption.
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	Pacts have not been used to date.

3. Internal controls

A. Internal audit

Companies generally are not required by law to conduct internal audits or to establish such a function. But there is such a requirement for financial institutions including commercial banks and finance companies, according to regulations of the central bank, Nepal Rastra Bank (NRB). Internal audits of banking institutions must be conducted every six months, and the internal auditors are to report to the audit committee, which reviews all findings.[9] Internal auditors in Nepal are not organized as a profession, nor are their professional standards defined by law or overseen by a governing body for the profession.[10]

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	Only financial institutions required to have internal audit, per NRB regulations.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect "illegal acts" in the books and records of companies, including bribery and other forms of corruption.	1) and 2): No organized profession, governance organization, or detection duties.
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	1) Basic internal audit required for financial institutions only, per NRB. 2) and 3): No requirements specified. 4) Banking institution internal auditors must report to the audit committee.

B. Audit committee

The audit committee is a requirement for banking institutions and for companies above a size threshold. Commercial banks have been required since 2001 to form audit committees (NRB Directive 6, art. 2.2), provide them by-laws, and in each case appoint a non-executive director as chair. The audit committee must review the bank's financial condition, internal controls, the audit program, and the findings of the internal auditor – who must report to the committee. The committee also reviews the external audit report and takes necessary corrective action, ensuring that the accounts are accurate. In the years following the introduction of audit committees in the financial sector, it was believed that they were often ineffective (World Bank 2005: Principle VI.E.). There was no general requirement in this area until the Company Act, 2006 went into effect. Under the Act (art.164), any company listed with paid up capital of NPR 30 million (USD 297,000[11]) or more, any company with full or partial state ownership, must have an audit committee. The committee is to have at least three members with a non-executive director (not related to the CEO) as chair and at least one member with accounting expertise. The board must implement the committee's recommendations concerning accounts and financial management. The Company Act (art. 165) spells out the audit committee's functions and powers, including the following:

- Review and verification of company accounts and financial statements
- Review of internal financial control and risk management systems
- Supervision of internal audit function
- Oversight of external audit including nomination of auditors and review of audit performance according to applicable standards
- Setting of policies on accounts and audits.

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	1) Banks, larger companies, enterprises with state ownership must have audit committees per Company Law and NRB rules. 2) Company law requires independent director as chair and at least one member with accounting expertise.
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers. employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	1) and 2): Required by Company Law and NRB regulation. 3) through 5): guidance and responses to audit problems to be given, but no explicit provisions on corruption.

C. Internal control and compliance systems

Internal controls, including ethics codes and compliance systems, are not legally required for most businesses. The development of corporate social responsibility and company codes of ethics is at an early stage in Nepal. Boards have no general responsibilities in this this area, but should not violate any existing laws. NRB Directive 6 establishes the requirement for banks to adopt and observe the NRB Code of Ethics. This Code covers directors and employees, and addresses conflicts of interest and related matters. There is no code for non-financial companies (World Bank 2005: Principles I.B. and VI.C.). The Company Act (art.109(4)) requires companies with paid-up capital or annual turnover of NPR 10 million (USD 99,000) to prepare, in addition to the annual report, a separate board of directors report for the period. Among other matters, it must state whether there is an internal control system in place or not, and the details of any such system.

International standard	Compliance by member country
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees. 4) Risk-based approach: • Individualized assessment of risks to the enterprise, including corruption risks. • Regular monitoring and re-assessment of corruption risks.	1) Disclosure of internal control system required by Company Act. 2) Audit committee review of internal controls required by Company Law and NRB regulation. 3) No requirement. 4) No requirement
Substantive components: 1) Require adherence to all applicable	1) through 4): No requirements.

laws and standards on behavior that may affect the integrity of financial statements. 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations. 4) Require for third-party representatives, consultants, or agents: • Written contract, adherence to company ethics standards and anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	
Enforcement, including sanctions for failure to comply.	No specific enforcement measures stated.

4. Integrity of financial statements

A. Accounting

1. Financial records

Companies in Nepal are legally required to keep proper accounting records. The Income Tax Act, 2000 (art.81) mandates that every taxpayer keep (in Nepal) documents sufficient to determine the amount of tax due and to explain information in the returns. The same provision specifies that the records must be maintained for five years. The Company Act (art.109 (8)) includes a matching five-year retention period for company accounts and annual financial statements Corporate officers who prepare (or approve) any false annual financial statements, reports or returns, or who damage, falsify or fail to maintain accounting records, are liable to punishment (arts.109(9), 160, see below)).

International standard	Compliance by member country
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	Maintenance of proper records for five years, with sanctions for non-compliance, in Income Tax and Company Acts.
Prohibitions (UNCAC 12(3), OECD Convention 8(1), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	1) and 2): Prohibited and subject to fines and imprisonment under Income Tax and Company Acts. 3) through 6): No specific prohibitions.

2. *Financial reporting requirements*

The Company Act (arts.108-109) requires every company to keep accounts according to national standards. The boards of both public and private companies are to prepare annual financial statements (balance sheet, profit and loss, cash flow) that give a "true and fair view of the state of affairs of the company," to approve the statements, and to have them audited. The financial statement must be presented to the annual general meeting, and an abstract sent to all shareholders (arts.77, 84). Financial institutions must submit annual financial statements in a format prescribed by NRB (Banks and Financial Institutions Act, 2006, art.59).

Nepal has been converging its accounting standards with IFRS gradually over several years. This process is being managed by the Accounting Standards Board (ASB) is an independent statutory body charged with setting accounting standards, together with the Institute of Chartered Accountants of Nepal (ICAN). These institutions have committed to fully converge Nepal's national accounting standards with IFRS. These new Nepal Financial Reporting Standards (NFRS) are to be phased in. Implementation began with SOEs and multinational manufacturers.[12] For other companies, a number of NFRS are now mandatory while others are voluntary. Full compliance is to be phased in over the next few years, beginning with financial institutions in 2014-15, followed by other listed companies, insurers, and companies not defined as SMEs in 2016-2017. In the last period, Nepal intends to adopt the IFRS for SMEs (the full ASB definition is not available, but one basis for classification is debt of less than NPR 500 million or USDD 4.9 million).[13] There are currently no special standards for smaller firms. Included in the mandatory IFRS is IAS 37 on material contingent liabilities. This has been applied (as NAS 12) since 2006. Included in the phase-in is IFRS 10 (NFRS 10) on consolidated financial statements.[14]

According to a report some years ago by the World Bank (2005: Principle V.B.), the phase-in of international standards was somewhat compromised by uneven compliance:

> Because they are new, and because understanding of the standards in the market has not widely expanded in the market, compliance is very limited (and no companies interviewed were preparing statements according to NAS.)

Since that time, compliance has likely improved with the enactment of new legislation and the work of ASB, ICAN and others. The legislation includes greater oversight of financial statements. For example, under the Securities Act, 2006 (art. 5), issuing companies submit their financial statements for review by the Securities Board of Nepal (SEBON). Financial institutions have for many years been required to prepare their financial statements according to international standards and in a format prescribed by NRB, and to publish them in the newspapers. Here again, compliance was reported to be inconsistent, with NRB itself failing to meet some reporting and audit requirements (World Bank 2003: 100-109).

International standard	Compliance by member country
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) IFRS being phased in through 2017, per ASB and ICAN plan. 2) IFRS for SMEs intended for adoption by 2017. 3) IFRS 10 (NFRS 10) is in the phase-in of mandatory international standards.
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) Nepal has adopted IAS 37, addressing contingent liabilities, though disclosure of corruption offenses is not stipulated and is not normally required. 2) No explicit prohibition.

B. Audit

1. Auditing requirements

The Company Act (art.109-110) requires all companies established under the Act to have their financial statements audited. The annual financial statements and the report of the board must be approved by the board of directors and signed by the chairman and at least one director (art.109(7)). There is no requirement of certification by the CEO or CFO, although this is the usual practice (World Bank 2005). The auditor has the authority to require all necessary records and explanations to be provided by the company within a reasonable time (art.114). The auditor’s report must include the following (art.115):

- Whether required information and explanations were made available;
- Whether the books of account were properly maintained;
- Whether the financial statements were prepared in compliance with the prescribed accounting standards, and whether such statements are in agreement with the books of account maintained by the company;
- Whether the financial statements properly reflect the financial situation of the company,

- Whether the board of directors or any representative or employee has acted contrary to law or misappropriated any property of the company or caused it any loss or damage;
- Whether any accounting fraud has been committed in the company.

The auditor must sign the report, and in turn the audit report is to be included in the annual return, with the financial statements and annual general meeting resolution, to the Company Registrar's Office (arts.80,116).

The Banks and Financial Institutions Act contains parallel provisions on audits in the financial sector. Audited financial statements are to be prepared according to a procedure and format prescribed by NRB – and with the signature of the CEO, at least two directors, and the auditor (art.59). The auditor's report must cover the same ground as provided in the Company Act, including a statement as to whether any officer of the financial institution has acted contrary to the laws in force or committed any irregularity or caused any loss or damage to the institution (art.63). The auditor must forward the audit report to NRB (art.64).

As in the accounting field, standards in this area are governed by an independent body, the Auditing Standards Board (AuSB), established under the Nepal Chartered Accountants Act, 1997. The main function of AuSB is to review existing practices and to develop Nepal Standards on Auditing (NSA) for issuance and monitoring by ICAN. To date, the AuSB has formulated 30 NSA, and is in the process of updating and revising the remainder based on the ISA. The current standards in effect include ISA/NSA 240 and 250. ISA 315 and 330 are referred to but are not yet in effect.[15] There are no tailored standards for SMEs.

Audit standards are enforced through ICAN's self-regulatory powers. The 2005 World Bank review reported that ICAN itself recognized that conflicts of interest within that organization prevented consistent audit enforcement. A handful of audit reports were qualified each year (World Bank 2005: Principle V.C.).

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	Auditing controls are reasonably complete but do not address corruption directly.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	1) Per Company Act and Banks and Financial Institutions Act: All companies to perform annual audits. Audit reports to be submitted to Registrar and NRB. Banks must publish audited accounts. 2) No special standards for SMEs.
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	All companies to use NSA, which are largely converged with ISA including ISA/NSA 240 and 250.
Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks. 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	Per Company Act and Banks and Financial Institutions Act: 1) Auditor certifies accuracy of financial statements, and provides opinion on correctness of preparation as well as cooperation by the company. Internal control systems are not addressed. 2) CEO signature of audited financial statements required for banks but not other companies, which require signature by board members including chair. Corporate representatives must cooperate in providing documents and explanations to auditor, but misleading is not addressed.

2. Auditor reporting of improprieties

Auditing law and standards do not expressly require the reporting of corruption, internally or externally. Internal reporting of fraud or illegality required by NSA 240 and 250, although corruption is not addressed specifically. NSA 240 and 250 do not provide a legal duty to report externally, but audit reports submitted to the Company Registrar and NRB must state whether company directors or personnel acted contrary to law, misappropriated property of the company, or caused the company any loss or damage (Companies Act art.115, Banks and Financial Institutions Act art.63). Again, corruption is not addressed specifically, but these statements would clearly have to include reference to any acts of fraud or corruption that are discovered by the auditor. There is no safe harbor as such for reports to the authorities. The legal requirements to include statements about misappropriation and illegality would, however, provide the legal basis for disclosure under ISA/NSA, if not protection from liability for breach of confidentiality.

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	Internal reporting of fraud or illegality required by NSA 240 and 250, though corruption is not addressed specifically.
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").	1) NSA 240 and 250 do not provide legal duty to report externally, but audit reports submitted to Registrar and NRB must state whether company directors or personnel acted contrary to law, misappropriated property of the company, or caused it any damage. Corruption is not addressed specifically. 2) No explicit safe harbor.

C. Professional standards and independence

The Nepal Chartered Accountants Act (arts.5, 11) provides for the establishment of ICAN as the regulatory and professional development body for accountants and auditors, empowering it to set professional standards, define educational and licensing requirements, and impose discipline. ICAN reviews all requirements for consistency with IFAC standards, and has adopted the IESBA Code of Ethics 2010 for its members, effective 2011 (with ongoing updates and translations). ICAN has a disciplinary committee as required by the Act (art.13) to investigate complaints and information on breaches of accounting, audit, and ethics rules. As part of the IFRS roll-out, ICAN is conducting certification courses with technical assistance from the Institute of Chartered Accountants of India, and ASB held trainings and discussions on implementation.[16]

The actual qualifications of accountants and auditors have in the recent past not been sufficient to meet Nepal's needs and standards. The World Bank reported several years ago (World Bank 2005: Principle V.C.) that ICAN had about 7,000 members, of which less than 300 had passed the Chartered Accountant exam. The remaining registered auditors were reported to have very low qualifications and training. Auditors of banks must be Chartered Accountants (appointed from an NRB roster), but auditors listed companies need only be members of ICAN and hold a Certificate of Practice, though most such audits are reported to be done by Chartered Accountants. Correspondent representatives of the major international firms are the sector leaders Nepal – audit firms cannot be foreign owned.

The Companies Act (arts.111-119) and the Banks and Financial Institutions Act (arts.60-61) provide standards for the appointment and independence of auditors. Companies appoint auditors annually, forwarding the names to the Company Registrar's Office. Auditors of public companies are limited to three consecutive terms, and the restriction applies to partners and employees of the audit firm. The list of persons (including audit partners and their firms) who may not serve as auditors includes the following:

- Any director, consultant, or employee involved in the audited company's management (or their partners, employees, or relatives);
- A debtor to the company;
- A substantial shareholder or one holding one percent or more of the paid-up capital of the company (or close relative), or in the case of a bank, a person or institution having subscribed 1% or more of the shares in the bank;
- In the case of a public company, anyone working for government or a body with full or part government ownership;
- A person having interest in any transaction with the company (or close relative) or a director, officer or substantial shareholder of another company having any interest in any transaction with the company.

There are no legal prohibitions against auditors performing other work for audit clients. In practice, auditors perform tax and bookkeeping services for their audit clients. Auditors of public companies are both nominated and appointed directly by the shareholders. As a result, nominations can be unpredictable, with frequent changes of auditors and no board and management control over auditor quality. Company law is silent on the specific reporting relationship between the auditor and the company. In practice, the auditor reports to the board of directors or management. For financial institutions, the auditor reports to the audit committee. Auditors can be sued by shareholders in the event of loss, but there have been no reported cases of lawsuits against auditors (World Bank 2005: Principles V.C. and D.).

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) The Chartered Accountants Act empowers ICAN to set standards for qualification and licensing, and to carry out oversight and discipline. 2) ICAN has adopted the IFAC (IESB) Code.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	Per Company Act and Banks and Financial Institutions Act: 1) Appointment process and qualification of auditor defined. 2) No restriction. 3) Rotation after 3 years. 4) Restrictions on auditors with links to audited companies. 5) No restriction.
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) and 2): Chartered Accountants Act authorizes ICAN to set and enforce standards, define training requirements and programs. 3) ICAN monitors auditors, and audit reports are reviewed by Company Registrar and NRB. 4) Discipline provided by ICAN, though effectiveness said to be doubtful.

D. Enforcement

Penalties for record-keeping offenses are given in the Income Tax Act (arts.117-124). Persons failing to maintain proper documentation are liable to a penalty of NPR 1,000 (USD 10) or 0.1% of assessed income for that year – whichever is higher. False or misleading statements are subject to fines up to

100% of the underpayment of tax. Where a statement is false or misleading “in a material particular,” fines between NPR 40,000 (USD 390) and 160,000 (USD 1,600) can be imposed, along with imprisonment from six months to two years.

Accounting and audit offenses are addressed in the Company Act (arts.160-162). Fines of NPR 20,000 (USD 200) to NPR 50,000 (USD 490) and imprisonment of up to two years apply to the following offenses:

- A director or officer of a company who causes loss or damage to the company or any person by maliciously inserting false statements in any document of the company.
- A director or officer of a company who fails to maintain, or conceals or damages, books of account.
- An auditor who maliciously falsifies (by inclusion or omission) an audit report.
- An auditor who knowingly carries out an audit without proper qualifications.
- Any director of officer who fails to provide required annual financial statements or reports to the shareholders.

Fines of up to NPR 20,000 (USD 200) can be applied to companies, directors, managers, officers, and employees for failure to comply with provisions of the Company Act. The Company Registrar has supervision, investigation, and enforcement powers under the Company Act. The Registrar has limited resources and makes limited use of its nominal powers. It lacks a proper documentation and filing system (World Bank 2005: Principle I.C.).

The Nepal Chartered Accountants Act (art.41) fixes penalties for persons carrying out audits without the required credentials. Conducting an audit without a Certificate of Practice, as required by the Act, carries a penalty of up to NPR 2,000 (USD 20) and imprisonment for up to two years. The same monetary fines, and imprisonment up to three months, is the penalty for signing documents as an auditor without having obtained a Certificate of Practice. Other violations of the Act are subject to the same fines, along with suspension for up to five years and imprisonment for up to three months.

A concern that arises with these various enforcement provisions is the disparity between fines, which are extremely low at least in international terms, and prison terms, which are quite serious. While fines must be set in line with prevailing salaries and standards of living, the amounts fixed by law in Nepal appear too low to provide a deterrent to corporate officers and professionals.

International standard	Compliance by member country
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2): No explicit provisions on bribery or corruption. Fines are low, especially for companies, and enforcement has been weak due.
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Fines of up to USD 1,600 and imprisonment for up to 2 years for neglect or damage to account documents, falsehoods in financial statements, malicious falsification causing damage to the company. 2) Smaller fines apply to companies for breaches of the Company Act. 3) Enforcement appears to be weak.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Fines of up to USD 1,600 and imprisonment for up to 2 years for falsifying audit report, failing to cooperate with auditor, or auditing without a Certificate. 2) Smaller fines apply to companies for breaches of the Company Act. 3) Enforcement appears to be weak.

5. Conclusion and recommendations

A. General efforts to prevent corruption involving the private sector

Nepal has a wealth of activity in this area, as in others, led by civic organizations. Initiatives by the private sector are of more recent origin, but FNCCI has been active in private sector governance and integrity, including the development of an ethics code, and has carried out programs jointly with government. On the government side, CIAA has collaborated with FNCCI and civic institutions while also providing channels for corruption complaints. CIAA also uses rewards and offers of immunity to encourage corruption informants. Missing from this menu of activity is the use of integrity pacts, i.e. agreements where companies pledge to follow anti-corruption norms and monitor each other.

Recommendations

1) Build on existing activities to deepen private sector and government cooperation on corporate governance, company internal compliance measures related to corruption prevention, and performance monitoring.
2) Review the provisions of the Prevention of Corruption Act on protection of complainants and informers to ensure confidentiality and security from retaliation.
3) Encourage and facilitate integrity pacts in the private sector.

B. Internal controls

This area is less advanced than others in Nepal. Internal audit is not defined in terms of specific standards or procedures, and there is no organized professional or standard-setting body for internal auditors. Internal audit is required only of financial institutions, while audit committees must be maintained by financial institutions and certain larger companies and those with state participation. Internal controls, ethics rules, and compliance mechanisms are not required as such, though disclosure is mandated. In none of these internal governance areas do there appear to be any enforcement provisions or any express requirements to deal with risks of corruption.

Recommendations

1) Phase in wider requirements for internal audit, audit committees, and internal controls beginning with large, financial, and (partly) state-owned companies – and then all public companies.
2) Support the development of a formal internal audit profession and governing body.
3) Match requirements with enforcement provisions including sanctions.
4) Include specific provisions on detecting, preventing, and managing risks of, corruption.

C. Integrity of financial statements

Here, Nepal has been making progress with convergence to international standards, both IFRS and ISA. It is also notable that auditors must include in their reports any instances of fraud or illegality, and that these reports are shared with the regulators. However, accounting rules do not address off-the-books arrangements or other tactics to hide corruption; nor do the standards and disclosure requirements in general address corruption explicitly. Except for financial institutions, there is no mandatory certification of financial statements by CEOs/CFOs. In addition, rules on auditor conflict of interest and enforcement by ICAN are comparatively weak. At the same time, the numbers of fully-qualified auditors is constrained. Enforcement in general has historically been uneven, and this appears to continue due to lack of capacity and to the very low range of fines available as sanctions – though serious prison terms are also available as sanctions.

Recommendations

1) Expressly prohibit off-the-books dealings and other manipulations used to hide corruption, and consider increasing record retention period from five to at least seven, if not ten, years.
2) Strengthen support for auditor reporting of irregularities with a clear mandate to report corruption and an explicit “safe harbor” provision to protect auditors from liability.
3) Tighten rules and discipline on auditor conflict of interest. Address limited auditing capacity by liberalizing foreign participation in the auditing profession.
4) Revisit sanctions provisions to ensure that fines and prison terms are sufficiently strict but also proportionate. Increase fines and provide for appropriate adjustment by means of inflation adjustment, sliding scale, and/or percentage of remuneration.

Nepal Laws, Regulations, Policy Documents Referenced:[17]

Banks and Financial Institutions Act, 2006
The Companies Act, 2006
Competition Promotion and Market Protection Act, 2006
Income Tax Act, 2000
Nepal Chartered Accountants Act, 1997
Nepal Rastra Bank Code of Ethics
Nepal Rastra Bank Directive No.6/067 (2010), Provisions Relating to Good Corporate Governance, http://bfr.nrb.org.np/directives/Directives--Unified%20_Directives%20_2067%20_English.pdf
Prevention of Corruption Act, 2002
Securities Act, 2006.

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[16] Nepal submission, ICAN, p.7-18, http://www.ifac.org/about-ifac/membership/compliance-program/compliance-responses.
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Pakistan

1. Introduction

Pakistan has a growing and increasingly sophisticated private sector. Market competition is open and largely unrestricted across much of the economy. A special feature of the business sector in Pakistan is the increasing use of Islamic practices and structures.[1] Legislation addresses the application of Islamic doctrines in the preparation and presentation of financial statements. Such enactments include ordinances for regulating the financial reporting practices of *Modaraba* companies and incorporating auditors' opinions on payment of *zakat*.[2]

Actual market access, however, may depend on informal ties. Business must contend with a range of serious challenges posed by corruption, cronyism, and instability. The need for transparency and a level playing-field is especially evident in certain sectors of the economy where officials or former officials, and in particular the military establishment, appear to hold significant ownership stakes. Five large conglomerate structures, established as foundations, reportedly manage thousands of businesses, in principle on behalf of pensioners and others entitled to military benefits. The companies range from local bakeries to banks and industrial plants, with the military's total ownership estimated in 2007 at USD 20 billion. Analysis of holdings by the four largest foundations showed that some 90% of the companies owned were not subject to public financial reporting.[3] However strong the rationale for such investment practices may be, they inevitably pose risks of undue influence and corruption. Transparency of accounts, internal controls, and beneficial ownership arrangements takes on crucial importance in this situation.

Corruption is reported to be seriously impeding business in Pakistan. Transparency International reported in 2009 that corruption in privatizations in Pakistan is endemic and manipulation of the process can be found at all stages. According to the World Economic Forum Global Competitiveness Report 2012-2013, companies point to corruption as the most problematic factor for doing business in the country after government instability. Business executives surveyed by the same source report that public funds are also regularly diverted to companies, individuals, or groups due to corruption. Encounters with tax authorities are reportedly used by officials as an opportunity to extort bribes and by companies as an opportunity to pay less tax in exchange for undue payments. Tax evasion is also distorting competition between companies that comply with tax regulations and those that do not – although government reports that the Economic Advisory Council has proposed measures to strengthen compliance. Protection of property rights and fair resolution of commercial disputes are hampered by inefficiency and corruption in the judiciary.[4] The independent and proactive Supreme Court, on the other hand, has repeatedly moved against corrupt individuals. But, given the scarce resources available to the court, it remains to be seen whether this can bring systemic change.[5]

2. General efforts to prevent corruption involving the private sector

Pakistan's anti-corruption efforts involve links to the private sector, but there appears to be no special, sustained effort to build cooperation between public and private sectors in this area. The National Anti-Corruption Strategy (NACS), adopted in 2002, includes the objectives of reducing opportunities for corruption in the private sector and building government's partnerships in this area with the private and civic sectors. The NACS emphasizes preventive approaches such as integrity pacts and codes of conduct. The National Accountability Bureau (NAB) takes the lead in implementing these approaches through such means as awareness-raising events and publications, and targeted prevention activities. Pakistan's other public agencies of accountability are also concerned with the prevention of corruption, and in this capacity reach out to the private sector from time to time. The Auditor General's Department has been updating its capabilities and pursuing a reform agenda to implement international best practices. Also important in this regard are the Public Accounts Committee of Parliament and the Ombudsman, which responds to complaints about public services at federal and provincial levels, and refers corruption cases for prosecution.

Corporate and financial regulation also supports the prevention of corruption in the private sector. Thus, the Securities and Exchange Commission of Pakistan (SECP), the lead regulatory authority for the corporate sector, promotes improvements in corporate governance, financial reporting, and transparency. Its main instruments for this purpose are the Code of Corporate Governance for listed corporations, and the Public Sector Companies (Corporate Governance) Rules 2013 for state-owned companies. These codes include requirements for establishing company codes of ethics. The Anti-Money Laundering Law 2010 (sec.7) also assists in detection and prevention of corruption by requiring all financial institutions to file suspicious transaction reports with the Financial Monitoring Unit if there is reason to suspect the transactions are related to illegal activities.

International standard[6]	Compliance by member country
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	Anti-corruption linkages exist between private sector and state institutions, but no sustained program.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) NAB and Ombudsman provide reporting channels. 2) No such provision.
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) SECP promotes improvements in corporate governance, financial reporting, and transparency (listed and public sector companies). NACS in general raises awareness and pursues preventive measures. 2) and 3): SECP policies include requirements for establishing corporate codes of ethics.
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	These instruments are not used to any significant degree, though they are mentioned in the NACS.

3. Internal controls

A. Internal audit

Pakistan's Code of Corporate Governance 2012, requires all listed companies to establish sound internal controls and to have an effective internal audit function. There is no defined procedure or framework for internal audits, which can vary from one organization to another. Internal audit reports are required to highlight any cases of fraud, bribery, corruption, or material irregularities. The head of internal audit reports functionally to the audit committee, while working administratively under the CEO. This internal audit chief must have at least five years' audit experience and a recognized professional certification or membership. Listed companies must ensure that internal audit reports are submitted for review to the external auditors, and any major findings reported to the audit committee and the board.

What the Corporate Governance Code does not address here is the requirements for companies – even very large companies – that are not listed on the stock exchange. Further, the administrative line of authority from the internal auditor to the CEO (rather than the board) leaves room for doubt whether the internal audit function has sufficient internal autonomy.

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	In principle, internal audit requirement and minimum qualifications of internal auditors provide sufficient controls to listed companies.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect "illegal acts" in the books and records of companies, including bribery and other forms of corruption.	For listed companies: 1) Qualifications of internal auditors set by Corporate Governance Code, including 5 years' experience and certificate or membership in recognized professional body. 2) Professional duty not defined as such, but internal audit rules require it.
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	1) All listed companies are required to establish sound internal controls and have an effective internal audit function (Corporate Governance Code). There is no defined procedure for basic internal audit. 2) No requirement. 3) Internal audit reports are required to highlight cases of fraud, bribery, corruption, etc. 4) Head of internal audit functionally reports to audit committee and administratively reports to the CEO.

B. Audit committee

Under the Corporate Governance Code, every listed company is required to establish an Audit Committee. The chairman must be an independent director (but not chairman of the board), and at least one member of the audit committee must have relevant financial expertise and experience. The audit committee recommends to the board the appointment of external auditors, their removal, audit fees, and the provision of any non-audit services by the external auditors. The committee’s responsibilities include:

- Review of financial statements prior to their approval by the board, focusing on areas of judgment, significant adjustments resulting from the audit, compliance with applicable accounting standards, and compliance with statutory and regulatory requirements.
- Facilitating the external audit and discussion with external auditors of major observations arising from audits.
- Review of internal audit and ensuring that the internal audit function has adequate resources and is appropriately placed within the company.
- Ascertaining that the internal control systems including financial and operational controls, accounting systems, and the reporting structure are adequate and effective.
- Monitoring compliance with best practices in corporate governance, and consideration of major findings of internal investigations of activities characterized by fraud, corruption and abuse of power -- and management's response.

Non-listed companies are not required to have audit committees, but sometimes establish them as a matter of good practice. As above, the requirement excludes large non-listed firms.

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	1) Listed companies required by Corporate Governance Code to establish audit committees. 2) The audit committee must be chaired by an independent director and include a member with financial expertise.
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers. employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	Audit committees of listed companies (per Corporate Governance Code) are required to: 1) Safeguard the company's assets and review financial statements, recommend to the board the appointment of external auditors, their removal, audit fees, etc. 2) Ascertain that the internal control systems, including financial and operational controls, are adequate and effective. 3) No requirement. 4) Consider major findings of internal investigations of activities characterized by fraud, corruption and abuse of power – and management's response. 5) Board should establish channel for complaints about unethical practices (see below), but not required to house this in audit committee.

C. Internal control and compliance systems

The Corporate Governance Code imposes requirements in this area on companies listed on the stock exchange. The boards of such companies must ensure that professional standards and corporate values are put in place that promote integrity on the part of the board, senior management, and other employees. This is to take the form of a code of conduct, which the board must disseminate throughout the company along with supporting policies and procedures. These provisions are to appear on the company's website. The board must also establish adequate systems for receiving and processing grievances arising from unethical practices. A sound system of internal control is to be established and effectively maintained at all levels of the company – and statements to this effect must be incorporated in the annual directors' report for the corporation. As stated above, the system is to be monitored by the audit committee.

As with the provisions discussed above, these do not address non-listed companies even if they are quite large. Non-listed companies do sometimes establish internal controls as a matter of good practice, although it is not known how widespread this practice is. Even in the case of listed corporations, the relevant provisions of the Corporate Governance Code are quite general. They do not specify the components of internal control, testing requirements, explicit prohibitions of corruption, nor guidance about gifts or retention of agents.

International standard	Compliance by member country
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees. 4) Risk-based approach: • Individualized assessment of risks to the enterprise, including corruption risks. • Regular monitoring and re-assessment of corruption risks.	Per Corporate Governance Code: 1) Listed companies to annex statements to the annual directors' report stating whether internal control system is sound and effectively implemented. Company code of conduct and supporting policies to be placed on corporate website. 2) Audit committee monitors internal controls. 3) Listed companies to disseminate code of conduct throughout company, along with supporting policies and procedures. Adequate systems to be put in place for identification and redress of grievances arising from unethical practices. 4) No requirement.

Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements. 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations. 4) Require for third-party representatives, consultants, or agents: • Written contract, adherence to company ethics standards and anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	1) Per Corporate Governance Code, listed companies must adopt a code of conduct to enshrine professional standards and corporate values that promote integrity. Audit committee monitors legal compliance. 2) to 4): No requirement
Enforcement, including sanctions for failure to comply.	No enforcement provisions.

4. Integrity of financial statements

A. Accounting

1. Financial records

The books of account of every company must be kept in good order for ten years, according to the Companies Ordinance, 1984 (art.230). The provision defines “document” as a source of information for accounting purposes, whether in electronic or other form, and including vouchers, registers, legal instruments such as summons, etc. The article fixes sanctions for failure to keep books properly. Further, the Ordinance (art.492) defines sanctions for false statements in any report, book of accounts, balance sheet, etc. Other forms of manipulating documents and accounts are not addressed explicitly, though government survey responses state that these are covered by the above-mentioned provisions.

International standard	Compliance by member country
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	Definition of “document;” ten year retention period. All companies must comply.
Prohibitions (UNCAC 12(3), OECD Convention 8(1), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	1) False statements in documents prohibited by Companies Ordinance. 2) through 6): Covered in general terms by provisions of Companies Ordinance on proper bookkeeping and on false statements – but no express prohibitions.

2. Financial reporting requirements

Pakistan has adopted most (but not all) of the International Financial Reporting Standards – a notable exclusion being IFRS 1. The remaining international standards, including the IFRS for SMEs, are either under consideration or in the process of adoption.[7] All companies listed on the stock exchange and all "Economically Significant Companies" (ESC) are required to comply with the adopted IFRS, while other companies must meet national Accounting and Financial Reporting Standards (AFRS) as defined by ICAP.[8] An ESC is defined as having two of the following: (i) turnover in excess of PKR 1 billion (USD 9.4 million[9], excluding other income), (ii) more than 750 employees, and (iii) total borrowings (excluding trade creditors and accrued liabilities) in excess of PKR 500 million (USD 4.7 million). ICAP has defined two sets of standards – one for medium-sized and another for small enterprises – for firms that do not fall within the IFRS requirement (ICAP 2006: 12). In addition, SECP exempts private companies from the requirement of filing annual and quarterly accounts with SECP or the Companies Registrar.[10]

International standard	Compliance by member country
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) All companies listed on stock exchange and Economically Significant Companies are required to comply with IFRS (SECP Notification). 2) Alternative Accounting and Financial Reporting Standards apply to SMEs (SECP Notification). 3) Disclosures to include off-balance sheet items per IFRS 10 (listed companies and ESCs).
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) All companies to disclose material contingent liabilities per IAS 37 and AFRS sec.8. Materiality concerns impact on financial position. Practice is normally not to disclose prospective impacts of bribery under IAS 37.86. 2) No explicit prohibition.

B. Audit

1. Auditing requirements

Under the Companies Ordinance (art.233), all companies are required to have their accounts independently audited, published, and sent to the shareholders, stock exchanges, and SECP. ICAP, which is responsible for establishing audit standards for Pakistan, has been progressively adopting the ISAs as the mandatory norms for use by auditors. The international standards adopted to date include ISAs 240 and 250, requiring special attention to evidence of fraud and non-compliance with laws.[11] The external auditor is to certify that correct audit standards have been used and the accounts fairly represent the company's state of affairs, and to provide an opinion on the manner in which the financial statements have been prepared and presented (art.255(3)). On the company side, the balance sheet and profit and loss account must be approved by the directors and signed by the CEO and at least one director (art.241). The auditor is entitled to demand from the company any information or explanation that she/he deems necessary. If any officer of the company fails to allow the auditor access to any books and papers, or to give any information requested, or otherwise obstructs or delays the audit, the officer is subject to fines (art.255(1) and (7)).[12]

The introductory section of this report referred to business holdings by Pakistan's military. The question naturally arises as to whether such companies are in practice held to the same corporate governance standards, including external audits, as other businesses. It appears that military business assets are mainly privately held, and may include some large companies that would normally be audited under either the Companies Ordinance or public sector audit rules.

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	Audit rules for companies are fairly complete in principle, but are not rigorously applied to welfare foundations.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	1) All companies are required to have their accounts audited, published and sent to the shareholders, stock exchanges and SECP, per Companies Ordinance. 2) SMEs included, but not unincorporated enterprises.

<table>
<tr><td>Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.</td><td>ICAP progressively adopting ISA. This includes ISA 240 and 250.</td></tr>
<tr><td>Other requirements:
1) External auditor shall:
• Certify that the financial statements fairly represent the financial position of a company.
• Provide an opinion on the way in which financial statements have been prepared and presented.
• Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks.
2) Company obligations:
• Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer.
• Prohibition against corporate officers and directors misleading the external auditor.</td><td>Per Companies Ordinance:
1) External auditor certifies financial statements and provides opinion on method of preparation. Assessment and testing internal controls not included.
2) Accounts must be approved by directors and signed by CEO and at least one director, certifying that they give a true and fair view of the affairs of the Company. Company officers must provide auditor necessary documents and requested information. Officer who fails to do so or hinders an audit is subject to penalties.</td></tr>
</table>

2. Auditor reporting of improprieties

Pakistan has adopted ISA 240 and 250, with the legal and materiality limitations that go with those standards. No safe haven for external reporting is provided. Thus, internal reporting is required, but external reporting to the authorities is not.

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	Internal reporting of fraud and illegality required per ISA 240 and 250. Corruption should be included, but is not specifically identified in the standards.
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").	1) Duty to disclose exists in limited form per ISA 240 and 250. 2) No safe harbor identified in materials reviewed or survey responses.

C. Professional standards and independence

The Institute of Chartered Accountants of Pakistan (ICAP) regulates the accounting profession by statute.[13] Its powers include qualification, licensing, training, monitoring, inspection and professional discipline. The Institute awards the Chartered Accountancy qualification, and is responsible for issuing auditing standards and for recommending accounting standards for adoption by the SECP. The Chartered Accountants Ordinance sets out the fundamental professional norms and provides procedures for investigating and imposing sanctions in cases of breach of professional ethics. [14]

ICAP oversees auditors' registration, qualification, licensing, training, monitoring, inspection and professional discipline. ICAP's Quality Control Review Committee monitors the quality of external audits. The Companies Ordinance (arts.252-255), Code of Corporate Governance, and Listing Regulations of the Karachi Stock Exchange provide for external auditors' tenure and safeguards of independence (SECP undated b: 5-12). The auditor is appointed at the annual general meeting and holds office for the financial year. Companies must notify their registrar of the appointment. Shareholders may remove an auditor from office by passing a special resolution, provided there is proper justification by terms of the Companies Ordinance (art.253). SECP may step in to appoint an auditor in such circumstances as failure to designate an auditor, or removal of the auditor. Several categories of persons are ineligible to perform external audits, including anyone having been a director, officer, or employee of the company in the prior three years, a director's spouse, or a shareholder or debtor to the company. A shareholder has 90 days to divest.

Additional requirements apply to certain categories of companies (Corporate Governance Code; Companies Ordinance art.254; SECP undated b: 5-12). Public companies (and their subsidiaries), along with private companies having paid-up capital of PKR 3 million (USD 28,000) or more[15], must choose chartered accountants as their auditors. Listed companies face several more stringent standards. Their auditors (and partners in the audit firms) must be fully compliant with IFAC guidelines as adopted by ICAP. Listed corporations' auditors may not provide non-audit services except as provided in regulations and IFAC guidelines. Nor may close relatives of a company's CEO, CFO, internal auditor, or director be involved in an external audit. Last, those listed companies operating in the financial sector are required to rotate auditors every five years. The tightening of standards for larger, public, and financial sector companies seems to fit the logic of proportionality and risk-based regulation – the question remains how well these are implemented in practice.

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) ICAP oversees the accounting profession. 2) Code of conduct and sanctions defined by statute.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	Per Companies Ordinance and Corporate Governance Code: 1) Auditors appointed for one year, with notice to Registrar. Public companies (and subsidiaries), and companies meeting capital threshold must appoint as auditor a chartered accountant. 2) Auditors of listed companies not to do non-audit work except as allowed by IFAC rules. 3) All listed companies in the financial sector must change external auditors every five years. 4) Ineligible as auditors: director, officer or employee of the company during preceding three years; spouse of a director; shareholder or debtor. 5) Information not available.
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) and 2): ICAP regulates auditors' qualifications, licensing, training. Auditors of listed companies (and partners in audit firms) must comply with IFAC guidelines as adopted by ICAP. 3) ICAP monitors quality of external audits. 4) ICAP exercises professional discipline.

D. Enforcement

Regarding financial documents and reporting, the Companies Ordinance (arts. 230(7) and 492) provides a range of sanctions. Any person making a statement in any report, balance sheet, accounts, etc. which is false in any material particular, is subject to fines up to PKR 500,000 (USD 4,700). If a company fails to comply with bookkeeping standards, every director including the CEO and CFO who contributed to this default is subject to imprisonment up to one year and fines up to PKR 50,000 (USD 475) and PKR 5,000 (USD 50) for each day the default continues (for listed companies), or six months' imprisonment and PKR 10,000 (USD 95) in fines (for other companies). Government provided the following data on penalties against company officers under the above provisions:

	2012	**2011**	**2010**
Number	42	27	29
Penalties	PKR 0.01 million to PKR 2.8 million (USD 95 to USD 26,000)	PKR 0.02 million to PKR 2.1 million (USD 190 to USD 20,000)	PKR 0.1 million to PKR 7.5 million (USD 945 to USD 71,000)

The Companies Ordinance (art.234(6)) applies the same penalties described above for failure to comply with financial reporting standards. The penalties in this case apply to the responsible auditors and audit firms as well as corporate officers. SECP and ICAP levy penalties, while the courts handle prosecution. Government provided the following data on imposition of these penalties:

	2012	**2011**	**2010**
Number	43	8	8
Penalties	PKR 5,000 to PKR 100,000 (USD 50 to USD 945)	PKR 5,000 to PKR 10,000 (USD 50 to USD 95)	PKR 25,000 to PKR 100,000 (USD 240 to USD 945)

Other penalties are established specifically for violation of audit standards and procedures (Companies Ordinance arts.255-260; SECP undated b: 13). Company officers who do not cooperate fully with external audits may be fined PKR 5,000 (USD 50), with additional small daily amounts for continued violation. If a company does not comply with the rules on appointment and independence of auditors, the company itself as well as officers who wilfully violate the rules are subject to fines up to PKR 50,000 (USD 475) and small daily fines for continuing infractions. If an auditor report or company financial document is incorrectly certified or contains material misstatements or omissions, the auditor and the certifying officer are subject to fines up to PKR 100,000 (USD 945) – and the auditor is also liable to one year's imprisonment if the violation is shown to be with intent to profit the auditor.

The Registrar of Companies, which is housed at the SECP, is empowered to enforce these provisions of the Companies Ordinance. Its enforcement of accounting and auditing standards was described as "constrained by inadequate technical capacity" in a 2005 World Bank analysis, although efforts were then underway to increase the numbers of qualified staff. SECP's capacity to review the financial statements of listed companies and to enforce reporting standards was similarly limited. No effective mechanism then existed, according to the World Bank analysis, to enforce requirements of accounting and financial reporting for non-listed companies. (World Bank 2005: 3, 12). This was due in part to the private companies' not being required to file financial statements with the Registrar, and to the lack of a provision in the Companies Ordinance for auditing of private companies below the stated capital threshold (PKR3 million or USD 28,000). For its part, ICAP carries out quality control reviews of audit firms, to ensure compliance with IFAC requirements of quality assurance (World Bank 2005: 51).

Overall, the penalties as fixed and as applied appear rather light, and well below deterrent level if the violations relate to hiding corruption. (Perhaps the 2010 fine amounting to USD 71,000 is an exception.) It appears that no companies have been penalized in recent years. The shortfall in enforcement capacity is also worrisome.

International standard	Compliance by member country
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2): For neither accounting nor audit is it clear that rules and procedures are fully used to combat corruption.
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) and 2): Fines up to USD 4,700, imprisonment up to 1 year for officers of any company in violation of bookkeeping standards. Company itself is not liable. Smaller penalties for financial reporting violations. 3) SECP levies penalties, courts deal with prosecution.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) and 2): Small penalties for audit-related violations, some applicable to companies. Imprisonment up to 1 year for auditor in case of violation for auditor's gain. 3) SECP levies penalties, courts deal with prosecution.

5. Conclusion and recommendations

A. General efforts to prevent corruption involving the private sector

In Pakistan, NAB and others interact with the private sector on anti-corruption issues, but there appears to be no sustained effort to build a partnership. SECP has been active in promoting good corporate governance and providing seminars.

Recommendations

1) Build public-private cooperation to prevent private sector corruption through such means as partnerships, sentence-mitigation provisions, and channels for self-reporting of corruption.
2) Sponsor seminars on preventing corruption.
3) Promote integrity pacts to encourage companies to follow ethics standards in important sectors such as government procurement, and to police these standards through peer review.

B. Internal Controls, Ethics, and Compliance

The systems and structures for internal control are reasonably well-developed in Pakistan, but only for listed companies. Even here, there is little explicit focus on corruption-related matters, and the administrative reporting of the internal auditor to the CEO may reduce this function’s independence.

Recommendations

1) Phase in requirement of internal audit, audit committee, and internal control systems for non-listed companies, beginning with large firms. Provide for enforcement of the requirements, and include guidance and oversight on prevention of corruption as audit committee responsibilities.
2) Strengthen internal audit by defining a basic required process, and by bringing internal audit under the direct administrative authority of the board of directors.
3) Provide an explicit corruption-prevention focus for internal control, including prohibition of bribery, and guidance on risky areas such as gifts and agents. Require assessment of controls by external auditors.

C. Integrity of Financial Statements

Pakistan has a fairly complete set of standards and procedures here, but with a few notable gaps in such areas as reporting of irregularities by external auditors, and enforcement.

Recommendations

1) Provide an explicit prohibition of manipulating accounts and reports to disguise corruption, and a duty to disclose contingent liabilities due to corruption.
2) Harmonize audit standards for private, public, listed, and financial companies. Restrict hiring of former auditors by client companies.
3) Provide a "safe harbor" for auditors reporting fraud and corruption to external authorities, and strengthen the duty to report.
4) Stiffen penalties and expand corporate liability for violations, incorporating acts of corruption in the punishable offenses. Strengthen enforcement mechanisms.

Pakistan Laws, Regulations, Policy Documents Referenced:

Chartered Accountants Ordinance (X of 1961), http://www.icap.org.pk/wp-content/uploads/meb_dept/handbook/Part_I_Ordinance_1961.pdf .
Code of Corporate Governance, 2012.
Companies Ordinance, 1984 (XLVII of 1984), http://www.secp.gov.pk/corporatelaws/pdf/CompaniesOrdinance1984_02-10-13.pdf .
Listing Regulations of the Karachi Stock Exchange
Public Sector Companies (Corporate Governance) Rules 2013.
Securities and Exchange Commission of Pakistan, Notification of Aug.21, 2007, Fifth Schedule, http://www.secp.gov.pk/notification/pdf/2007/Notifi_Aug21_SRO(5thsch).pdf.
Securities and Exchange Commission of Pakistan (undated), A Guide on Accounts and Accounting Reference Dates, p.12, http://www.secp.gov.pk/SECGuideSeries/PDF/accounting_guide.pdf
Securities and Exchange Commission of Pakistan (undated b), *A Guide for Appointment of Statutory Auditors and Ancillary Matters,* p.10, www.secp.gov.pk/Guides/auditors_guide.pdf.

NOTES

[1] World Bank (2005), *Report on the Observance of Standards and Codes (ROSC): Pakistan Accounting and Auditing*, p.5.
[2] Respectively, a *shar'ia*-compliant investment vehicle (providing appropriate distribution of risk and profit), and the Islamic duty of dedicating a portion of income to charity.
[3] The above analysis first appeared in a book by Dr. Ayesha Siddiqa, published in 2007. Najad Abdullahi, "Pakistani army's '$20bn' business," *Al Jazeera*, Feb. 17, 2008, http://www.aljazeera.com/focus/pakistanpowerandpolitics/2007/10/2008525184515984128.html ; Declan Walsh, "Book shines light on Pakistan military's '£10bn empire,'" *The Guardian*, May 30, 2007, http://www.theguardian.com/world/2007/may/31/books.pakistan.
[4] http://www.business-anti-corruption.com/country-profiles/south-asia/pakistan/snapshot.aspx.
[5] BTI (2012), Pakistan Country Report, http://www.bti-project.org/countryreports/aso/pak/.
[6] The sources of all standards are provided in footnotes to the tables presented in the section of the Review entitled *International Standards for Country Reports.*
[7] The Institute of Chartered Accountants of Pakistan (2006), Members Handbook: Part V Accounting, p.9.
[8] SECP Notification of Aug.21, 2007, Fifth Schedule, http://www.secp.gov.pk/notification/pdf/2007/Notifi_Aug21_SRO(5thsch).pdf.
[9] All currency conversions are at interbank rate as of Jan. 25, 2014, www.oanda.com/currency/converter/.
[10] Securities and Exchange Commission of Pakistan (undated), *A Guide on Accounts and Accounting Reference Dates*, p.12, http://www.secp.gov.pk/SECGuideSeries/PDF/accounting_guide.pdf.
[11] World Bank 2005: p.11; Institute of Chartered Accountants of Pakistan (2012), *Members Handbook Part VI: Auditing.*
[12] Securities and Exchange Commission of Pakistan (undated b), *A Guide for Appointment of Statutory Auditors and Ancillary Matters,* p.10, www.secp.gov.pk/Guides/auditors_guide.pdf.
[13] Chartered Accountants Ordinance, 1961 (X OF 1961), http://www.icap.org.pk/wp-content/uploads/meb_dept/handbook/Part_I_Ordinance_1961.pdf.
[14] http://www.icap.org.pk/
[15] This would include companies of nearly all sizes – the largest "small" companies are defined in the Corporate Governance Code as having paid-up capital (plus undistributed reserves) of Rs.25 million (USD 235,000).

Palau

1. Introduction

The Republic of Palau is an archipelago of some 340 islands with a population of just over 20,000 living on eight of the islands. The country participates in a Compact of Free Association with the United States, and has directly elected executive and legislative branches with an advisory Council of Chiefs. Palau has a high standard of living relative to other Pacific island states, but also faces development challenges typical of the region. These include a small population and a high cost of service delivery due to the expense of imported goods and expertise. The service sector dominates the Palauan economy, contributing more than 50% of GDP and employing over half of the work force. The government alone employs nearly 31% of workers and accounts for 20 per cent of GDP. High-end tourism is becoming an important factor in the economy, with business and tourist visitors exceeding 100,000 annually. Under the compact, the US government is providing significant aid, along with programs operated by over 40 federal agencies – and the currency used in Palau is the US Dollar (USD). In terms of the investment climate, the IFC gives the country a score of 2.7 for Strength of Investor Protection, and zero for Extent of Disclosure (out of a possible score of ten).[1]

2. General efforts to prevent corruption involving the private sector

Palau is an electoral democracy in which civil rights are respected. There are no political parties, though no laws prevent their formation. The current system of loose political alliances that quickly form and dismantle has had a destabilizing effect on governance. Official corruption and abuse remain serious problems. Many public officials have been implicated and found guilty in recent years, including several national and state officials – among them the Ombudsman – in 2009. To improve transparency and financial accountability, new anti-money-laundering measures were introduced in 2007, though evaluations have found significant deficiencies in due diligence, record keeping, and monitoring, and the Attorney General's office lacks the resources to oversee implementation of these measures.[2] Thus, Palau has significant corruption problems but is also making efforts to respond. Apart from the money laundering measures, however, it is not clear what steps government is taking to cooperate with the private sector in combating business-related corruption.[3] As for private sector initiatives, the Palau Chamber of Commerce works with ADB's Private Sector Development Initiative, and in 2013 put on a series of training sessions on corporate governance.[4]

International standard[5]	Compliance by member country
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	Some efforts by government and by business community, though not yet effective.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) and 2): There is an Ombudsman, though its effectiveness is in question. It is unclear what other mechanisms are available.
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors. 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) through 3): Government institutions including the Ombudsman have been implicated in corruption in recent years. The chamber of commerce has worked with ADB to increase awareness and improve corporate governance standards.
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	These do not appear to be used to any significant extent.

3. Internal controls

Palau does not appear to have general legal standards for internal governance of companies. However, the Prudential Regulations for financial institutions make it the responsibility of the board of directors of a bank operating in Palau to adopt sound standards of corporate governance and ensure that the standards are fully implemented.[6]

A. Internal audit

Internal audit is not specified under the company or banking laws of Palau, or the prudential regulations (though it is referred to in the banking legislation, see below).

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	No internal audit requirement.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect "illegal acts" in the books and records of companies, including bribery and other forms of corruption.	1) and 2): No organized internal audit profession.
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	1) through 4): No provision.

B. Audit committee

There is no general requirement or recommendation for companies to establish audit committees or supervisory boards. However, the Financial Institutions chapter of the Palauan legal code[7] (arts. 1056, 1059) requires each financial institution to have an audit committee. The audit committee is to have at least three members appointed by the board of directors for up to two years (and meeting the same basic qualifications as board members). The committee's responsibilities are to establish appropriate accounting procedures and controls and supervise compliance with them, to nominate auditors (internal or external), to monitor regulatory compliance and report on it to the board, and to advise the board, retaining outside experts as needed. The Prudential Regulations (FIC-PR-09, Part III, 1(a)) reaffirm the committee requirement, adding that licensed banks are to adopt and implement formal written policies for audit and compliance, as well as other matters.

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	1) Only financial institutions required to maintain audit committees. 2) Audit committee members to meet same basic requirements as board members.
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers, employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	Per Financial Institutions law: 1) Audit committee to establish and supervise accounting procedures and related controls, and nominate auditors. 2) Audit committee to monitor regulatory compliance. No mention of internal code. 3) through 5): No explicit provision.

C. Internal control and compliance systems

Companies generally are not required or induced to establish internal controls, but there are requirements in this area for financial institutions. The law on Financial Institutions (26 PNCA secs.1056, 1059) mandates establishment of a risk management committee, which is tasked with establishing, and monitoring implementation of, policies and procedures relating to credit, loan administration, and management of market and interest rate risks. The committee is also to monitor compliance with laws and regulations applicable to credit and other risks. In addition, the law also requires disclosure of potentially unlawful transactions to the Financial Intelligence Unit, and disclosure (to the licensed institution) of any manager's material interest related to a transaction of the institution (26 PNCA secs. 1062-1063). Institutions are also required to have policies on executive conflicts of interest, as well as procedures to ensure that managers and employees are not placed in situations that create conflicts with their fiduciary duties to the institution and its customers. The Prudential Regulations (FIC-PR-09 Part III, sec. 1) require licensed banks to adopt and implement formal written policies for asset-liability/risk management. Further, included in the licensing application is a required statement of executive officers' duties. Among those duties are responsibility for operations and internal controls, and investments and asset-liability management.[8] The above provisions are enforced mainly through the licensing and supervision processes of the Financial Institutions Commission (FIC).

International standard	Compliance by member country
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees. 4) Risk-based approach: • Individualized assessment of risks to the enterprise, including corruption risks. • Regular monitoring and re-assessment of corruption risks.	1) Only financial institutions required to have internal controls. These are to be reported to FIC in license application and supervisory filings. Institutions must have risk management committee. 2) through 4): No provision.
Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements.	1) Financial institutions: Risk management committee to establish policies and procedures on the main types of risk, and to monitor compliance

2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations. 4) Require for third-party representatives, consultants, or agents: • Written contract, adherence to company ethics standards and anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	with these and with relevant laws and regulations. 2) Financial institutions must have conflict of interest standards and disclosure rules. Also, money laundering risks to be reported to FIU. 3) and 4): No provision.
Enforcement, including sanctions for failure to comply.	Enforcement of bank requirements by means of FIC licensing and supervisory processes.

4. Integrity of financial statements

A. Accounting

1. Financial records

Companies in Palau are required to keep correct and complete books of account, financial records and documents such as receipts, and minutes of proceedings.[9] Financial institutions must keep books of account including a daily ledger, and accounting records. The record must exhibit clearly and correctly the state of the institution's business affairs, explaining its transactions and financial position sufficiently for preparation of financial statements in accordance with accounting standards approved by the FIC (26 PNCA secs.1052, 1075). The regulations (FIC-PR-09, PART III, sec.1 (d)) reaffirm these provisions. Further, branches of foreign banks are required to maintain records and books of account in Palau sufficient to reflect the activities of the branch, including the daily ledger (balance sheet), income statement, accounting records, credit documentation, and minutes of committee meetings.

There appears to be no legally required retention period – this may be addressed in regulations or case decisions.

International standard	Compliance by member country
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	Corporate and banking regulations require proper record-keeping, but no minimum period fixed.
Prohibitions (UNCAC 12(3), OECD Convention 8(1)), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	1) through 6): No provision.

2. *Financial reporting requirements*

The Corporation Regulations require every for-profit Palauan and foreign company to file an annual report with the Registrar of Corporations. The report is to be a “full and accurate exhibit of its state of affairs.” The Registrar may, in addition, require the production of any books and papers, and examine a company’s officers, members, or others under oath. The Registrar is authorized to file for a court order to compel compliance if necessary.[10]

The financial reporting requirements for banks and similar institutions are more detailed. Financial institutions must prepare annual financial statements in accordance with US Generally Accepted Accounting Principles (GAAP) or other accounting standards approved by the Commission. The statements are to include a balance sheet and statement of income (on a consolidated basis), and provide a full and fair view of the bank’s financial condition. For branches or subsidiaries of foreign banks, the statements must be prepared both on a consolidated basis for the entire foreign bank and for the branch or subsidiary on a stand-alone basis (the latter standard also applies to banks insured by the US. FDIC). The statements of all banks must be filed with the FIC, published in a newspaper of general circulation in Palau, and posted in the lobby of the bank's head office in Palau and branch locations in Palau.[11] The treatment of contingent liabilities (including those related to acts of corruption) is understood to be similar under US GAAP as compared to IFRS.[12]

International standard	Compliance by member country
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) Corporations to submit annual statements to Registrar, banks to submit them to FIC and publish them. US GAAP or other approved reporting standards to be used. 2) No special requirements stated. 3) Banks to report on consolidated basis, and foreign banks also on stand-alone basis.
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) US GAAP treatment is similar to IFRS (IAS 37). In either case, disclosure of potential corruption-related liabilities would not normally be required. 2) "Full and accurate" requirement of Corporation Regulations addresses this generally, but no express prohibition.

B. Audit

1. Auditing requirements

The law on companies ("Business Associations") authorizes the government to appoint officers to audit and report on the accounts of corporations doing business in Palau. The officers have the right to inspect, examine, and audit the books and accounts of these corporations.[13] Thus, there is no uniform audit requirement for companies, but the government is able to determine which companies or categories of firms should be audited, on a case-by-case basis.

The law on Financial Institutions (26 PNCA arts. 1082-1086) requires banks to have their financial statements audited by a licensed CPA approved by the Commission, and to submit the audited financials to the Commission for its review. Also, the FIC is to conduct regular examinations of institutions, including branches of foreign banks – and these inspections may be done by Commission auditors. As part of its on-site examinations, the FIC has the right to compel production of any books, accounts, documents, or information – and a bank's failure to comply is subject to penalties. The Prudential Regulations[14] require each bank to produce audited financial statements prepared on a consolidated basis within six months of the end of each fiscal year. The institution must submit to the Commission the complete audit report together with the opinion of the auditor, and the auditor's letter to management.

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	Audit requirements are not comprehensive, though they may be proportionate. Whether they are sufficient for anti-corruption purposes is unclear.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	1) and 2): Registrar of Corporations audits selected companies case-by-case. All banks must have annual audits and publish financial statements.
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	No stated requirement to use ISA. Registrar of Corporations and FIC may use supervisory discretion to require US standards or ISA.

Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks. 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	1) Financial institutions: auditor report to be submitted with audited financial statements, which must provide true and fair view. No provision on testing of internal controls. 2) No certification requirement or general duties of cooperation with auditor. Failure to cooperate with Registrar or FIC audit is penalized.

2. Auditor reporting of improprieties

Auditors have no explicit general duty to report on irregularities. However, auditors of financial institutions are required to report to the Commission if they discover in the course of an audit that there has been a serious breach of the banking laws or regulations, an apparent crime involving fraud or other dishonesty, or serious irregularities including any that jeopardize the security of depositors and creditors. No duty of confidentiality is to be regarded as having been violated by the auditor's good faith reporting of these or related matters (26 PNCA 1083). Importantly, the duty to report is not restricted by any criterion of materiality, and while it does not mention corruption, this appears to be comprehended within its terms – e.g. fraud, dishonesty, irregularity.

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	No general duty of auditor to report irregularities.
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").	1) Auditors of financial institutions must report immediately to FIC if the audit indicates serious illegality, crime of fraud or dishonesty, irregularities that may harm stakeholders. As supervisor, FIC has authority to purse these matters with management or otherwise. 2) Safe harbor provision protects bank auditors from liability due to breach of confidentiality.

C. Professional standards and independence

Palau does not appear to have its own accounting and audit profession, but to rely on professionals licensed elsewhere and on standards accepted internationally. As for the independence of auditors, the issue arises only in the financial sector. The applicable law (26 PNCA sec.1082) states that no one may audit a bank who has any interest in the audited institution, other than as a depositor, or is an officer, employee, or agent of the bank. A bank auditor who obtains any such interest or position is immediately disqualified.

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) and 2): No national profession or standards.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	Financial Institutions: 1) Auditors must be approved by FIC. 2) and 3): No provision. 4) Auditor may not have financial interest or position as officer, employee, or agent of audited bank. 5) No provision.
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) through 4): No national profession, body, or standards.

D. Enforcement

The code provisions on Businesses and Financial Institutions contain some enforcement provisions. There are various penalties for late submission of information and reports. Failure by a corporation to produce books, documents, or information demanded by the Registrar within 30 days is subject to fines up to USD 50 and in the case of an individual, imprisonment for up to 90 days (12 PNC sec.124). A company's failure to file its annual financial statement may be penalized by the cancellation of the corporate registration.[15] Failure by a financial institution to submit a statement of its current financial position as demanded by the FIC is subject to a penalty of USD 1,000 per day as long as the violation lasts (26 PNCA sec.1084). When the FIC compels the production of documents for an examination or audit, failure to produce the material by the deadline is subject to a fine of USD 5,000 per day (26 PNCA sec.1086). The FIC is empowered to deal with other violations of the Financial Institutions law by issuing written warnings, entering agreements with a bank for remedial action, issuing a cease and desist order to protect stakeholders, and imposing fines on the financial institution or its managers or principal shareholders of up to USD 10,000 per day as long as the violation lasts (26 PNCA sec.1091).

International standard	Compliance by member country
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2): Accounting and audit provisions do not appear to be sufficient for combating corruption, though they are reasonably strict in some cases (e.g. audits of banks).
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) through 3): Companies: cancellation of registration is sanction for failure to file annual statements. Banks: Failure by financial institution to produce a timely accounting of the current financial situation as demanded by FIC is subject to daily USD 1,000 fines. Other contraventions may result in daily fines up to of USD 10,000 or restraining measures by FIC.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) through 3): Companies: failure to produce materials in response to Registrar's demand for inspection is subject to fines of USD 50 per day and imprisonment up to 90 days. Banks: failure to produce materials in response to FIC demand for inspection/audit is subject to USD 5,000 per day fines. Other contraventions may result in daily fines up to of USD 10,000 or restraining measures by FIC.

5. Conclusion and recommendations

A. General efforts to prevent corruption involving the private sector

Palau is making some efforts to deal with problems of corruption. These efforts appear mainly to consist of government reforms such as the establishment of the Ombudsman and the anti-money laundering legislation. These efforts are themselves hindered by corruption and limited capacity. Separate efforts are underway on the private sector side, including the chamber of commerce program with ADB. Neither the development of codes on business ethics and corporate governance, nor integrity pacts to engage the private sector in mutual policing of clean and transparent business practices, are in evidence.

Recommendations

1) Reinforce the capacity and accountability of the Ombudsman (or similar institution), coupling it with provision for corruption self-reporting incentives such as sentence mitigation
2) Launch a public-private initiative to develop codes of business ethics and corporate governance. Include in the effort awareness-raising, training, and support for integrity pacts among companies including banks.

B. Internal controls

Companies in Palau are generally not required by law to establish an internal audit function, an audit or supervisory committee, or internal control and risk management systems. Banking law and regulations, however, do require audit committees and internal controls, and refer to internal audit on the assumption that institutions have it though it is not legally required. The audit committee rules for banks outline the duties of these bodies, but not in detail and not with respect to corruption prevention. The internal control provisions are a normal feature of financial sector regulation, and risks related to banking business are a major focus. The internal control provisions are otherwise silent on the details of this function, including aspects of internal company norms and corruption prevention.

Recommendations

1) Build on the initial activities of the chamber of commerce-ADB program to promote awareness and expertise on internal audit, audit committees, and internal control systems for both financial

and other companies. Adopt a code of corporate governance addressing issues such as these.

2) Revise the financial sector rules on audit committees and internal controls to provide more detailed terms of reference, including prevention of corruption. Also, provide explicit rules or guidance on internal control system reporting relationships – i.e. to the board, the external auditors, and/or the audit committee – and public disclosure of internal control systems.

C. Integrity of financial statements

Palau has legal requirements for record-keeping applicable to financial and other companies. The general corporate provisions lack detail, and in neither case is a retention period defined nor the various forms of record manipulation prohibited. Companies are required to file annual financial statements. In the case of the banks, the statements are filed with the FIC and must meet US GAAP or other standards approved by FIC. Palau has no national financial reporting or auditing standards, but uses US standards, which are largely consistent with international standards. The Registrar of Corporations audits companies on a case-by-case basis, while all financial institutions must be audited annually and submit financials statements and audit reports to FIC. There is little detail on audit procedure or the required content of audit opinions, nor is certification by company officers mandated. In general, auditors are not required (or permitted) to report improprieties to external authorities, but in the case of bank audits this is both required and protected. However, no guidance seems to be provided on the auditor's bringing these matters to the attention of the company itself. Palau does not have its own structured accounting and audit profession, but relies on internationally-trained professionals. The latter must be approved by the FIC for purposes of any financial institution audit. Enforcement provisions for the accounting and auditing rules appear incomplete, although the Registrar and the FIC do have authority to levy significant penalties.

Recommendations

1) Define a retention period for accounting records of seven years. Prohibit the key record destruction and manipulation methods associated with concealment of corruption.
2) Clarify what the required financial reporting and audit standards are, and apply them consistently to financial institutions and to corporations, excepting small businesses as locally defined.
3) Develop audit rules, especially for banks but also other (non-exempt) corporations, to provide clear guidelines for procedure, audit opinions, certification by company officers, and auditor discussion of irregularities with company management.

4) Extend public financial reporting requirements beyond the banking sector to corporations more generally. This may require phasing-in and setting a threshold so that small companies are not unduly burdened. Back up the public disclosure rules with both detailed disclosure guidelines and serious penalties – to improve corporate governance and counter Palau's adverse reputation with respect to corporate disclosure.

Palau Laws, Regulations, Policy Documents Referenced:

Corporation Regulations, http://www.doingbusiness.org/~/media/FPDKM/Doing%20Business/Documents/Law-Library/Palau-Corporation-Regulations.pdf

Financial Institutions Chapter 10, 26 PNCA 1001, http://www.ropfic.org/pdf/laws/26%20PNCA%20Chapter%2010%20Financial%20Institutions%20Act.pdf

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NOTES

[1] http://www.dfat.gov.au/geo/palau/palau_brief.html; https://www.cia.gov/library/publications/the-world-factbook/geos/ps.html; IFC (2014), *Doing Business 2014: Economy Profile – Palau*, the World Bank Group.

[2] http://www.freedomhouse.org/report/freedom-world/2010/palau#.UzNduPldUfU.

[3] There may indeed be other initiatives underway that have not been covered due to lack of information.

[4] http://micronesiachambers.com/palau-chamber-launches-corporate-governance-training-series/.

[5] The sources of all standards are provided in footnotes to the tables presented in the section of the Review entitled *International Standards for Country Reports.*

[6] Financial Institutions Commission, Prudential Regulation FIC-PR-09, *Corporate Governance*, art.3, http://www.ropfic.org/pdf/regulations/FIC%20PR-09-Corporate%20Governance.pdf. In this report, the terms “financial institution” and “bank” are used interchangeably for the sake of convenience.

[7] Financial Institutions Chapter 10, 26 PNCA 1001, http://www.ropfic.org/pdf/laws/26%20PNCA%20Chapter%2010%20Financial%20Institutions%20Act.pdf.

[8] Prudential Regulation FIC-PR-07, License Applications, Attachment 1 sec.D.3, http://www.ropfic.org/pdf/regulations/Prudential%20&%20Administrative%20Regulations.pdf.

[9] Corporation Regulations, Chapter 1, sec.2.21, http://www.doingbusiness.org/~/media/FPDKM/Doing%20Business/Documents/Law-Library/Palau-Corporation-Regulations.pdf.

[10] Corporation Regulations, Chapter 1, sec.5.4 and Chapter 3, secs.1.11-1.13.

[11] 26 PNCA secs.1081-1084; Prudential Regulation FIC-PR-11 , *Publication and Disclosure*, Part III, secs.1-4, http://www.ropfic.org/pdf/regulations/FIC%20PR-11-Publication%20and%20Disclosure.pdf.

[12] Ernst & Young (2012), US GAAP versus IFRS: The basics, pp.13, 35, http://www.ey.com/Publication/vwLUAssets/US_GAAP_versus_IFRS:_The_basics_November_2012/$FILE/US_GAAP_v_IFRS_The_Basics_Nov2012.pdf.

[13] Republic of Palau Statutes on Business Associations, 12 PNC, sec.104, http://www.doingbusiness.org/~/media/FPDKM/Doing%20Business/Documents/Law-Library/Palau-Statutes-on-Business-Associations.pdf.

[14] Prudential Regulation FIC-PR-03, *Statistical and Related Information*, Part III, sec.3, http://www.ropfic.org/pdf/regulations/Prudential%20&%20Administrative%20Regulations.pdf.

[15] Corporation Regulations, Chapter 3, sec.1.15.

Papua New Guinea

1. Introduction

Papua New Guinea, a lower-middle income island nation of some seven million people, is a dynamic society facing serious governance challenges. Mineral and gas production has sustained economic growth for more than a decade (along with inflation), but with increasing fluctuation in recent years. The ExxonMobil-led Papua New Guinea LNG project represents one of the country's most important growth opportunities, with large facilities being built in the Southern Highlands and Port Moresby. Australia and PNG have a Joint Understanding for transparent governance of the project's revenue by means of a new sovereign wealth fund. There are risks here including the adverse terms of trade and distorted development termed the "resource curse," along with the possibility of continued volatility in national revenues due to fluctuations in global resource prices. These extractive sector investments and construction projects drive the formal side of PNG's dual economy, providing a narrow employment base – with many of the jobs filled by foreign labor. The majority of the population works in the informal sector, where subsistence farming accounts for the bulk of economic activity. Unemployment is estimated to be higher than 70%, and a like proportion of the population lives below poverty line. Migration to city centers in the past decade has contributed to urban unemployment and social problems, while rural land disputes, lack of supportive policies, and problems of law and order have contributed to the decline of once robust agricultural sub-sectors such as coffee production by smallholders.[1]

Papua's intense political and social conflicts are inherent in the effort to bring thousands of ethnic and social groups spread across rugged terrain into a modern state system – within just a few decades. The rapid transition has made evolving government institutions vulnerable to corruption and capture. Further, the state has struggled to sustain a real monopoly on the use of force, challenged as it is by urban criminal gangs referred to as "raskols" and tribal groups engaging in more traditional forms of warfare. Gang activity is also reported to be migrating into white-collar crime. Criminal elements on the street cooperate with high officials or politicians able to exert influence to protect and share the proceeds of illicit activities. Elections are reportedly plagued by massive vote buying, ballot rigging, clan voting, violence, intimidation, and cheating in several regions. Political authority is in practice often captured by clan and regional loyalties, powerful business groups and interest groups such as landowners and the military. Also, while protections on political expression and organizing are respected, the checks and balances within the state often are not.[2]

Corruption is reported to be entrenched, including at the top echelons of the government administration. A small economy and a low level of trust across clan and tribal lines seem to abet corruption and make it difficult to combat. Monopolies and oligopolies create significant barriers to new market entrants by such means as political influence and "facilitation money." Commissions of inquiry have found numerous instances of public tenders being awarded to companies or individuals who have bribed officials. Also, corruption in land administration has undermined enforcement of property rights and encouraged the takeover of lands, including parcels in urban centers, by individuals using connections with the government and big companies. Many senior politicians continue to escape prosecution for corruption and abuse of power. Under PNG's Leadership Code, when an elected leader resigns, she/he cannot be prosecuted for misconduct, although criminal charges are possible. After the 2011 election, the government formed Task Force Sweep, a multi-department/agency group charged with pursuing fast-track investigations into corruption and quick prosecutions.[3]

2. General efforts to prevent corruption involving the private sector

In addition to specific anti-corruption campaigns such as Task Force Sweep and commissions of inquiry, PNG has some established organizations addressing this area. On the government side, the Ombudsman Commission combines a traditional complaints jurisdiction with authority to administer the Leadership Code. Its primary function is to investigate, in response to complaints or on its own initiative, allegations of defective public administration, discriminatory practices, and misconduct in office under the Leadership Code. The Commission considers itself a *de facto* anti-corruption agency. In the absence of a specialized agency in this area, the Commission takes the lead responsibility for addressing suspected corruption. This is supported by its ancillary powers to refer matters to the Supreme Court as a constitutional "watchdog," to participate in judicial appointment processes.[4]

On the private sector side, the lead organization appears to be the Papua New Guinea Institute of Company Directors (PNGID), which represents over 25% of company directors including small local businesses and large international companies. PNGID's stated objective is to promote good corporate governance in private, public, and non-profit entities. It also represents the interests of company directors in PNG with respect to national policy formulation and implementation. The Institute has articulated a general set of Principles of Good Corporate Governance that members sign onto, and also advocates the adoption by businesses of internal codes of conduct reflecting the Principles. PNGID's efforts are especially significant since no governmental body as yet appears to have issued standards in this area. The Port Moresby Stock

Exchange Limited (POMSoX), in its capacity as a self-regulatory organization, has developed listing rules that require timely, accurate, and high-quality information disclosure, along with officer compliance with principles of integrity and accountability.[5] The Exchange is still evolving, with some 20 listed companies at present. In addition, civic organizations such as the local Transparency International affiliate, TIPNG, conduct awareness campaigns on corruption and advocate for reforms in such areas as public administration, elections, and financial transparency.[6]

International standard[7]	Compliance by member country
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	Government, private sector, and civic initiatives are ongoing. Level of cooperation among them is unclear.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) Ombudsman Commission provides channels for reporting and complaints, and also carries out investigations. 2) Incentives such as sentence-mitigation do not appear to be provided. Severe challenges to law and order appear to make this difficult.
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) PNG has not formally created a lead anti-corruption agency. Ombudsman Commission takes on this role, among its other responsibilities. It does not appear to engage in outreach or partnerships on private sector corruption. 2) and 3): Standard-setting efforts underway by Institute of Directors and Port Moresby Stock Exchange. Business Against Corruption Alliance has announced the development of a Code of Conduct.[8]
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	These do not appear to be used to any significant degree. Opportunities and beginnings are apparent, e.g. in TI PNG campaigns on extractive industries and protection of forests against illegal logging.

3. Internal controls

A. Internal audit

In PNG, there is no general legal requirement of internal audit for listed companies or other businesses. Nor is internal audit mentioned in the PNGID or POMSoX standards. However, internal audit is practiced as a matter of good corporate governance. The PNG chapter of the Institute of Internal Auditors has some 200 full members.[9]

Further, internal audit is required in the financial sector. The Bank of PNG in 2012 issued Corporate Governance prudential standards for companies that it supervises under the Superannuation (general provisions) and Life Insurance Acts of 2003, requiring them have in place internal audit and compliance functions.[10] The institutions regulated under the Banks and Financial Institutions Act 2000 are also required to have internal audit and compliance functions.[11] The effectiveness of these functions is assessed when the Bank does its on-site supervision of the institutions annually. The financial institutions regulated by the Bank of PNG have developed and continue to revise their cooperate governance structures to meet best practice. Most, if not all, are also subscribed and certified members of ISO 9001, which places emphasis on internal controls and audit functions.

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	Internal audit is not generally required by law, except for financial institutions and insurers. Relevant professional and regulatory standards apply.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect "illegal acts" in the books and records of companies, including bribery and other forms of corruption.	1) Internal audit standards not defined by law, but there is a professional community guided by the PNG chapter of IIA. 2) Duty not imposed by law but contained in IIA standards.
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	1) through 4): No general legal or regulatory requirement. For financial institutions and insurers, Bank of PNG prudential standards require internal audit and compliance functions. Bank of PNG does on-site supervision and off-site surveillance on all authorized financial institutions to assess effectiveness of these functions.

B. Audit committee

Bank of PNG prudential standards require all regulated financial institutions to have board audit committees.[12] The effectiveness of such functions is assessed when the Bank does its annual on-site supervision of the institutions. The financial institutions regulated by the bank of PNG have developed and are continuing to develop their corporate governance structures. Most if not also have or are subscribed and certified members of ISO 9001 which places emphasis on internal controls and audit functions.

Otherwise, no legal requirements or regulatory standards provide for an audit committee or similar structure. The Companies Act[13] (art.111) does enable company boards, consistent with their corporate charters, to delegate functions to committees or individuals, thus affording a legal basis for the establishment of an audit committee.

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	1) and 2): No general audit committee requirement or standard. Companies Law enables establishment of committees of the board. Bank of PNG prudential standards require authorized institutions to have board audit committees Membership not specified.
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers, employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	1) through 5): No general requirement applicable to companies. Bank of PNG prudential standards require authorized institutions to have board audit committees. Committee terms of reference not specified in detail. Bank of PNG does on-site supervision and off-site surveillance on all authorized financial institutions to assess effectiveness of these functions.

C. Internal control and compliance systems

As in the above areas, there are no explicit legal requirements or regulatory standards here for companies in general. The PNGID and POMSoX standards mention integrity, disclosure, ethical codes, and legal compliance as model principles or values, without addressing control systems or methods. The Companies Act, again without mentioning internal control systems as such, does impose certain integrity requirements. Thus, the Act (arts.117-119) requires directors to disclose material interests in company transactions by reporting them to the board or entering them in a company registry of interests. In defined cases, the company may "avoid" or cancel a related-party transaction.[14]

As mentioned above, the Bank of PNG in 2012 issued corporate governance standards for financial institutions and insurers as part of its prudential regulations. These standards include requirements for internal audit and compliance functions. The effectiveness of these of these systems is assessed when the Bank does its on-site supervision. The financial institutions regulated by the Bank of PNG are continuing to develop their corporate governance structures.

International standard	Compliance by member country
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees. 4) Risk-based approach: • Individualized assessment of risks to the enterprise,	1) through 4): No legal requirements for companies generally, though Companies Act and corporate governance standards refer to ethics, disclosure, etc. Bank of PNG prudential standards address corporate governance and compliance for financial institutions and insurers. Internal control procedures not described in detail.

including corruption risks. • Regular monitoring and re-assessment of corruption risks.	
Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements. 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations. 4) Require for third-party representatives, consultants, or agents: • Written contract, adherence to company ethics standards and anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	1) through 4): No legal requirement to establish controls. Integrity, disclosure, and legal compliance are included in standards applicable to PNGID members and companies listed on POMSoX. Companies Law requires directors' disclosure of interests in corporate transactions. Bank of PNG prudential Standards address corporate governance and compliance for financial institutions and insurers. Content of internal controls not described in detail.
Enforcement, including sanctions for failure to comply.	Sanctions under the Companies Act apply if a director fails to disclose a material interest in a company transaction.

4. Integrity of financial statements

A. Accounting

1. Financial records

The Companies Act (art.188) requires companies to keep accounting records that correctly record and explain the transactions of the company, enable the financial position of the company to be determined with reasonable accuracy, and allow proper financial statements to be readily prepared and audited. The records are to be in writing or other accessible form convertible to writing, and must contain complete entries on money received and spent each day (and for what), assets and liabilities of the company, and details of any transactions in goods or services as part of the company’s business. The records are to be retained for ten years. Failure to comply is an offense by the company directors. Additional provisions in the Act (arts.164-165) require companies to keep other documents including financial statements, the interests register, and correspondence for seven years. The board must ensure that adequate measures are taken to prevent and detect any falsification of records.

International standard	Compliance by member country
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	Per Companies Act: All companies to keep accurate accounting records for 10 years. Records to be written or convertible, and enable accurate financial reporting and audit.
Prohibitions (UNCAC 12(3), OECD Convention 8(1)), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	Per Companies Act: 1) Directors must take steps to prevent and detect falsification of records. 2) Failure to preserve records for full retention period is an offense by the directors. 3) thtough 6): No legal prohibition.

2. Financial reporting requirements

The Companies Act (arts.179-187) requires all companies to prepare financial statements that comply with generally accepted accounting practice, give a true and fair view of the state of affairs, and are signed by two directors on behalf of the board. The same applies to the group financial statements required (with some exceptions) of companies with subsidiaries. Certain companies must submit copies of the financial statements (including any group statements) to the Registrar for registration, along with a copy of the auditor’s report. The companies required to do so are the same as those that must submit to external audits, i.e. companies with assets exceeding PGK 5 million (USD 1.8 million[15]), or having more than 25 shareholders or more than 100 employees (art.171). (There are exceptions for companies that are subsidiaries of firms that fall below the thresholds, and firms that meet some thresholds but whose shareholders agree not to appoint an auditor). These same companies must prepare annual reports and provide them to the shareholders – other companies are required to do so as well unless the shareholders agree to a waiver (arts.209-212). The annual report must provide an overview of the company's affairs, include the company's signed financial statements and the auditor's report (where applicable), and disclose specified information on officers' remuneration and other matters. The report is to be signed by two directors. In addition, all companies must file annual returns with the Registrar providing specified information on the company's affairs. For the companies subject to statutory audit as described above, the return is to include certified copies of the audited financial statements (art.215, Sched.6). Each foreign corporation operating in PNG must prepare and file financial statements according to the above rules for the company as a whole, and for its business in PNG (considered as a free-standing company). These companies must also file annual returns with the Registrar similar to those for domestic companies (arts.390-391).

Under the Banks and Financial Institutions Act (arts.28-29, 34, Sched.4), banking institutions are to file returns with the Bank of PNG, including their audited financial statements.[16] The banks are required to publish their financial statements and make them available to the public. The Central Bank has the power to inquire further, conduct special inspections, and penalize the submission of false or misleading information.

The Companies Act (arts.204-206) establishes the Accounting Standards Board (ASB) as the body responsible for reviewing and adopting financial reporting standards to be applied in PNG. The full suite of IFRS has been adopted and is obligatory for company financial reports under the Act, as well as for financial institutions supervised by the Central Bank. The IFRS are being implemented, but a further formality has reportedly not been carried out, i.e. final endorsement of the standards by the Accountants Registration Board (ARB). The Board apparently has not met regularly, and final approval had been expected for some time but not yet given, according to the most recent report.[17]

International standard	Compliance by member country
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) IFRS have been adopted for all company financial reports, though formal endorsement is pending. 2) All businesses incorporated under the Companies Act are to report according to IFRS – the SME version has apparently not been adopted. 3) Consolidated financial reporting required by Companies Act and by IFRS 10.
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) IAS 37 applies, requiring disclosure of material contingent liabilities but usually not prospective liabilities for corruption offenses. 2) No explicit prohibition, but directors are required to prevent and detect falsification of financial records by Companies Act.

B. Audit

1. Auditing requirements

The Companies Act (arts.171, 190), as noted above, requires external audits for companies with assets exceeding PGK 5 million (USD 1.8 million), or having more than 25 shareholders or more than 100 employees (with the exceptions noted). Auditors are to be appointed annually at the AGM – if none is appointed, the company must notify the Registrar, which has authority to appoint one. Failure to comply is an offense by the company and the directors. Private sector audits in PNG must comply with revised (“clarity”) International Standards on Auditing (ISA), which have all been accepted for this purpose by the Accounting Standards Board.[18]

The auditor is to prepare a report to the shareholders on the financial statement audit. The report must state whether proper accounting records have been kept by the company, whether the financial statements comply with applicable standards (or if not, in what way), and whether the statements provide a true and fair view of the company’s affairs (or if not, in what way). The report must also state any limitations to the scope of the audit, any relationships or interests the auditor has in the company or its affiliates, and whether the auditor received all the information and explanations required. Where the report indicates any non-compliance, the auditor is to submit a copy of the report to the Registrar for forwarding to the ASB. Audit reports for companies that fall below the statutory audit threshold have slightly less strict requirements. Companies are required to cooperate with their auditors, providing all information and explanations required, and facilitating the auditor's attendance at shareholders' meetings. Failure to comply is an offense by the company, its directors, and responsible employees (Companies Act, arts.199-203).

Institutions in the financial services sector are required to perform regular external audits. As mentioned above, the Banks and Financial Institutions Act (Sched.4) requires financial institutions to file annual returns, including their audited financial statements, with the Bank of PNG. The same applies to savings banks under the Savings and Loans Societies (Amendment) Act 1995 (art.30).[19] For financial institutions under the Bank of PNG, the latter requires any issues with the financial statements raised by the external auditors to be addressed accordingly. The Bank takes supervisory actions on any material findings by the external auditor.

The Audit Act[20] (arts.1, 3) deals with public sector audits. These cover most SOEs, defined as firms organized under the Companies Act and majority-owned by or on behalf of the government, as well as projects financed by a loan to be repaid in whole or in part out of public funds. The Auditor General is responsible for auditing the relevant organizations and reporting to Parliament. The audit is to examine the proper keeping of accounts, precautions to safeguard collection and custody of public moneys, compliance with applicable laws, proper authorization and accounting of expenditures, issues of efficiency and internal control, and related matters.

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	Audit requirements appear reasonably comprehensive and proportionate, though the effectiveness of audit in combating corruption in practice is unclear.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	1) and 2): Per Companies and Banking Acts, annual audits must be done by companies meeting a threshold as well as financial institutions. Audited financials to be submitted to Registrar or central bank, and in the case of banks, published.
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	PNG has adopted all ISA, including ISA 240 and 250.
Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks. 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	1) Per Companies Law, audit report must state whether accounts have been kept properly, financial statements properly prepared, and statements provide true and fair view. No provision on testing internal controls. 2) Financial statements to be signed by 2 directors. Company must cooperate with auditors or both company, directors, and responsible employees are liable.

2. Auditor reporting of improprieties

Audits are generally subject to ISA 240 and 250. Otherwise, the only explicit provision on auditor reporting of improprieties appears in the Banks and Financial Institutions Act (art.35). A current or former director, CEO, or auditor of a financial institution has a duty to report promptly to the Central Bank when there are reasonable grounds to believe that the institution is insolvent or at serious risk, or if "an existing or proposed state of affairs may materially prejudice the interests of depositors." A protective clause follows, stating that no duty is to be regarded as contravened by reason of the auditor's (or other official's) communicating in good faith to the Central Bank, whether upon request or not.[21] The financial institution itself has a duty to report information relevant to the Central Bank's functions or where failing to report would be misleading in some material way. Failure to comply with these duties is an offense. The Act (art.52) also defines as an offense the disclosure of protected information, but excuses this where it is compelled by law or assists the Central Bank in its functions.

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	Internal reporting of irregularities including corruption is required in most cases to meet ISA 240 and/or 250.
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").	1) Banking Law imposes a duty by the auditor to report to the Central Bank situations that are materially prejudicial to the depositors. This may but in many cases probably does not cover unreported acts of corruption. 2) Banking law provides safe harbor protection for the above and related reports by auditors.

C. Professional standards and independence

There are several institutions involved in governing the accounting and audit profession in PNG. The ASB, as mentioned above, was established by the Companies Act and is responsible for approving the accounting and audit standards applied to companies. Responsibility for quality assurance of accountants and auditors rests with the Accountants Registration Board (ARB) in accordance with the Accountants Act (arts.4, 15-16).[22] The ARB controls the registration of all accountants in business, the public sector, and auditing. It regulates the practice of accountancy, prescribing minimum qualifications, the professional ethics code, and standards to be used by the profession (CPA PNG Action Plan, p.3).

The Accountants Act (art.67) requires accountancy practitioners to be registered with Certified Practicing Accountants Papua New Guinea (CPA PNG). The organization develops the profession, provides training to meet continuing education requirements, and oversees ethics and discipline for the profession. Training of auditors is often provided by their employers, especially large firms and the public sector. CPA PNG has adopted the 2006 version of the IESBA Code of Ethics for Professional Accountants as the standard to guide the conduct of accountants, and intends to adopt the latest Code as a mandatory requirement for members (i.e. all practicing accountants). Under the Accountants Act, CPA PNG refers disciplinary matters to the Accountants Statutory Committee for investigation and sanctions. The Committee includes a representative of CPA PNG as well as other professionals and experts (CPA PNG Action Plan, p.5-9, 12).

The appointment and independence of auditors is addressed in the Companies Act (arts.193-198). A company auditor must be a Registered Company Auditor under the Accountants Act, and cannot be a director or employee of the company, or such person’s business partner or employee. Further, the auditor cannot be a liquidator or receiver of the company, a corporation, or anyone disqualified from auditing a related company. The incumbent auditor must be reappointed unless she/he becomes disqualified or gives notice that she/he does not wish to be re-appointed, or the company passes a resolution at the annual meeting to replace the incumbent. The departing auditor must be given the opportunity to make representations about the situation and the reasons for the change. Auditors are to avoid conflicts of interest that may impair their judgment.

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) Standards are set by Accountants Act and CPA PNG, which refers to a committee for discipline. 2) CPA PNG has adopted, and is updating to a newer version of, the IFAC-IESBA Code.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	Per Companies Act: 1) Appointment, qualifications, and replacement must comply with the Act. 2) and 3): No provision. 4) Restrictions on auditor's relationship with company, but not monetary interests. General rule of no conflicts of interest 5) No restriction.
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) ARB registers professionals, regulates practice. 2) CPA PNG, a membership body, develops profession, provides continuing education, and oversees ethics. 3) ARB supervises quality of practice. 4) CPA PNG refers matters to Statutory Committee for investigation and discipline.

D. Enforcement

The main legislative acts in this area all include sanctions provisions. The Companies Act states a graduated set of penalties, including the following (art. 413, Sched.13):

- Fines of up to PGK 10,000 (USD 3,560) apply to (i) failure by a company that is exempt from statutory audit to prepare proper, timely, or signed financial statements; (ii) failure to keep proper financial records; and (iii) failure to submit required annual reports. The penalty applies to all directors (arts.186, 188, 209).

- Fines of up to PGK 100,000 (USD 35,600) apply to failures by companies subject to statutory audit to (i) carry out the audit; (ii) prepare proper, timely, or signed financial (including group) statements; and (iii) submit annual returns as required. The penalty applies to all directors (arts. 185, 187, 215).
- Fines of up to PGK 50,000 (USD 17,800) and imprisonment for up to two years apply to failure to comply with the Registrar's requirements when it carries out an inspection (art.400).
- Fines of up to PGK 200,000 (USD 71,200) and imprisonment for up to five years apply to the following:

  - Knowingly making or authorizing statements or omissions, in documents required under the Act, that are false or misleading in a material particular. The penalty applies to directors or employees who are responsible or vote in favor of the statement or omission (art.420).
  - A director, employee, or shareholder fraudulently taking, using for her/his own benefit, concealing, or destroying property of the company or who falsifies, fabricates, alters, or destroys any company register or accounting records with intent to deceive (arts.421-422).

A court may order an offender to pay an additional pecuniary payment where the offense was committed with the intention of deriving benefits and benefits were in fact realized. The actual value of the benefits and other contextual factors are to be considered (art.415).

The Banks and Financial Institutions Act applies penalties to similar offenses. Failure to file annual returns with audited financials, and breach of confidentiality are subject to fines of up to PGK 100,000 (USD 35,600) and imprisonment for up to two years. Obstructing an auditor or examiner, and providing false or misleading information are subject to fines of up to PGK 500,000 (USD 178,000) and imprisonment for up to ten years. Penalties apply to companies as well as to corporate officers who participated in or consented to the offense (arts. 54 and 58, Sched. 5).

In addition, the Accountants Act (art. 57) provides that the Accountants Statutory Committee may apply sanctions to accountants and auditors for violation of professional and ethical standards. These include a reprimand, an order for payment of costs, fines up to PGK 10,000 (USD 3,560), and suspension or cancellation of registration.

International standard	Compliance by member country
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1)). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2): Sanctions available for offenses, especially those by companies and their directors and officers, are substantial. Whether they are used effectively against corruption is uncertain.
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Companies and Banks Acts provide for fines over USD 70,000 and imprisonment up to 5 years for financial reporting violations including intentional false statements. Accountants Act applies fines, suspensions, etc. to professionals. 2) Companies Act penalties apply to board of directors and to responsible officers. Banks Act penalties apply to companies and officers. 3) Effectiveness of enforcement is unclear.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Companies and Banks Acts provide for fines over USD 175,000 and imprisonment up to 10 years for audit and related violations including intentional false statements. Accountants Act applies fines, suspensions, etc. to professionals. 2) Companies Act penalties apply to board of directors and to responsible officers. Banks Act penalties apply to companies and officers. 3) Effectiveness of enforcement is unclear.

5. Conclusion and recommendations

A. General efforts to prevent corruption involving the private sector

Papua New Guinea must contend with conflict and corruption in extending state institutions across a diverse society and terrain. No formal anti-corruption agency exists, but the Ombudsman Commission takes on this role as part of its many tasks, providing a channel for complaints and launching inquiries on its own initiative. Private and civic sector initiatives led by the Institute of Directors, the Port Moresby Stock Exchange, and the PNG Chapter of Transparency International deal with corporate governance, transparency, and corruption in natural resource sectors.

Recommendations

1) Establish a central anti-corruption agency to take on a wider range of activities in this area than the Ombudsman. Private sector corruption could be major theme, and it could work with law enforcement to establish incentives such as sentence-mitigation to encourage private sector preventive action and self-reporting.
2) Support the development of a corporate governance code, with the first step being private sector integrity pact focused on corporate governance principles, accountability and transparency, and prevention of private sector corruption. The integrity pact would enable the private sector, with assistance from government and NGOs, to police the agreed standards.

B. Internal controls

There appear to be no legal or regulatory requirements in PNG applicable to companies in general concerning internal audit, audit committees, or internal control systems. Internal audit is practiced, and a substantial chapter of IIA is in operation. The Companies Act empowers boards to establish committees for delegated functions, but does not specify further. Integrity principles are advanced by PNGID and POMSoX but do not specifically call for internal control mechanisms, while the Companies Act requires entities to keep a register of interests and to disclose related-party transactions. Bank of PNG prudential standards require internal audit, compliance functions, and board audit committees, although the rules and procedures are not spelled out in detail.

Recommendations

1) Adopt legal requirements for internal audit, audit committees, and internal control systems for all companies meeting a threshold (e.g. the threshold for statutory audit). Require companies to disclose the details, operations, and problems of these systems.
2) Support a public-private initiative to develop a corporate governance code. This could be more detailed than the laws just mentioned, with higher voluntary standards and a broader reach – especially if all companies were actively encouraged to sign on.

C. Integrity of financial statements

PNG's legal requirements in this area are more complete, but could still be improved. Records must be retained for 10 years, and directors are required to take adequate measures against falsification. Other record manipulations are not expressly prohibited. All companies must prepare financial statements, and companies meeting the statutory audit threshold must also file annual returns with the Registrar, accompanied by their audited financials, and also provide annual reports to the shareholders. Similarly, banks are to file returns with the Central Bank. The IFRS have been adopted and should be used for all of these reports, but a final approval step appears to be pending. Statutory audits are to be done in accordance with the ISA, and are to include audit reports and opinions. Statements must be signed by two directors. As for the reporting of improprieties, only financial sector auditors are required to do so and protected in doing so – but these provisions are limited to situations that present material risks to the shareholders. This may not require the reporting of most fraud and corruption. Accounting and audit are regulated by a standards board (ASB), a registration and oversight board (ARB), and a membership body dealing with professional development (CPA PNG). The Companies Act provisions on auditor appointment and independence are not comprehensive, since they fail to require periodic rotation or to restrict non-audit services, financial interests, or eventual hiring by the client company of the auditor. The Companies, Banks, and Accountants Acts provide enforcement sanctions for financial reporting and audit offenses, including severe fines and prison terms up to ten years.

Recommendations

1) Prohibit the full range of accounting record manipulations that are associated with concealment of corruption, including off-the-books transactions.
2) Consider lowering the threshold for the requirement to file annual returns with the Registrar and to have financial statements audited. Ensure full adoption and enforcement of IFRS.
3) Strengthen and extend the requirement for auditors to report irregularities to outside authorities. Include companies outside the financial sector subject to statutory audit, and require reporting of fraud, corruption, and illegality beyond what is materially risky to the depositors. Extend the safe harbor provision as well.
4) Adopt comprehensive safeguards for auditor independence, including rotation requirement and restrictions on non-audit work and auditor interests in the client company. If this is overly constraining in light of the small audit profession, establish a waiver process.

Papua New Guinea Laws, Regulations, Policy Documents Referenced:

Accountants Act 1996. No. 58 of 1996, http://www.paclii.org/pg/legis/consol_act/aa1996141/.

Audit Act No. 1 of 1989, http://www.track.unodc.org/LegalLibrary/pages/LegalResources.aspx?country=Papua+New+Guinea.

Banks and Financial Institutions Act No. 2 of 2000, http://www.track.unodc.org/LegalLibrary/pages/LegalResources.aspx?country=Papua+New+Guinea.

Companies Act, No. 10 of 1997, http://www.paclii.org/pg/legis/consol_act/ca1997107/.

Savings and Loans Societies (Amendment) Act 1995, http://www.bankpng.gov.pg/images/stories/savings_loan_act.pdf.

NOTES

1 http://www.dfat.gov.au/geo/png/png_brief.html; http://www.bti-project.org/reports/country-reports/aso/png.
2 http://www.bti-project.org/reports/country-reports/aso/png.
3 http://www.bti-project.org/reports/country-reports/aso/png.
4 http://www.track.unodc.org/LegalLibrary/pages/LegalResources.aspx?

country=Papua+New+Guinea, http://www.lawandjustice.gov.pg/www/html/118-the-ombudsman.asp.

[5] http://www.pngid.org.pg/corp_govern_principles.html, http://www.pomsox.com.pg/listing_rules.aspx.

[6] http://www.transparencypng.org.pg.

[7] The sources of all standards are provided in footnotes to the tables presented in the section of the Review entitled *International Standards for Country Reports.*

[8] http://www.transparencypng.org.pg/coalitions/business-against-corruption-alliance. BACA is supported by the British High Commission (Port Moresby), Transparency International PNG and Port Moresby Chamber of Commerce & Industry.

[9] http://www.iia.org.pg/.

[10] http://www.bankpng.gov.pg/images/stories/Life%20Insurance/Prudential%20Standards/Life_Insurance_PS_9-2012_Corporate_Governance.pdf.

[11] As reported by government.

[12] As reported by government.

[13] Companies Act, No. 10 of 1997, http://www.paclii.org/pg/legis/consol_act/ca1997107/.

[14] IPA and Securities Commission are currently undergoing legislative reform.

[15] All currency conversions are at the interbank rate as of April 10, 2014, http://www.oanda.com/currency/converter/.

[16] Banks and Financial Institutions Act No. 2 of 2000, http://www.track.unodc.org/LegalLibrary/pages/LegalResources.aspx?country=Papua+New+Guinea.

[17] Action Plan Developed by Certified Practising Accountants Papua New Guinea (CPA PNG), p. 14, http://www.ifac.org/sites/default/files/compliance-assessment/part_3/201403%20Papua%20New%20Guinea%20CPAPNG.pdf.

[18] www.adoptifrs.org/uploads/Papua%20New%20Guinea/Financial%20Management%20and%20Governance%20Issues%20in%20PNG%20Ch4.pdf.

[19] http://www.bankpng.gov.pg/images/stories/savings_loan_act.pdf; government reports that this also applies to insurers supervised by the Bank of PNG.

[20] Audit Act No. 1 of 1989, http://www.track.unodc.org/LegalLibrary/pages/LegalResources.aspx?country=Papua+New+Guinea.

[21] The clause refers to “any other information or opinion, which is relevant” but appears to apply to all good faith reports to the Central Bank under this article.

[22] Accountants Act 1996. No. 58 of 1996, http://www.paclii.org/pg/legis/consol_act/aa1996141/.

Philippines

1. Introduction

The Philippines presents a mixed but increasingly positive picture. Corruption involving the private sector is substantial and of long standing, with social driving forces such as high concentration of wealth and an authoritarian legacy continuing to play a role. Government and the judiciary have not been able to restrain corruption effectively and at times have been part of the problem. On the other hand, the Philippines has one of the most open, active, and capable civil societies in Asia, with the result that campaigns for transparency and for reform of laws and state institutions to strengthen governance have made significant progress. This is reflected in the policies and practices discussed below.[1]

The Philippine economy suffers from limited competition, with monopolies and oligopolies impeding private sector diversification and growth.[2] Business executives surveyed by the Global Competitiveness Report 2013-2014 report that government officials often favor well-connected companies and individuals when deciding on policies and contracts and that public funds are often diverted to companies, individuals or groups due to corruption.[3]

According to the World Economic Forum's Global Competitiveness Report 2013-2014, companies identify corruption as the second most problematic factor for doing business in the Philippines. The level of government administrative requirements is perceived by the private sector as very burdensome. A 2012 report by Global Financial Integrity reported that, due to illicit activities such as corruption and tax evasion, the Philippines lost about USD 138 billion between 2001 and 2010. According to Global Corruption Barometer 2013, 31% of households perceive that the level of corruption in the Philippines has increased a lot in the past two years, and only 30% of the households perceive the government's efforts in fighting corruption as 'effective'.[4]

Yet, business surveys suggest that the situation, while still serious, is improving. In Social Weather Stations' Survey of Enterprises on Corruption 2012, surveyed enterprises reported a significant improvement in the government's fight against corruption between 2009 and 2012. Moreover, the surveyed business managers perceived the level of corruption in the private sector to be lower than in the public sector – in particular, the level of transparency in bidding for a government contract has increased. It is also reported that the solicitation of bribes in relation to getting local and national government permits and licenses has decreased. In March 2013, 1,700 companies signed an integrity pledge with the government, aiming to promote and abide by ethical and business standards, as reported by European Chamber of Commerce of the Philippines.[5]

2. General efforts to prevent corruption involving the private sector

In the Philippines, several public-private cooperation initiatives are moving forward. The lead state agency promoting public-private cooperation is the Office of the Ombudsman, the chief anti-corruption agency. It serves as single point of contact for reports of corruption, as well as an investigator and prosecutor. The Ombudsman also analyzes government regulations and operations, and makes recommendations (or issues orders) for reforms to enhance ethics and efficiency.[6]

In carrying out its mission, the Ombudsman seeks the cooperation of the private sector. In 2011, it signed a memorandum of understanding with three business associations providing for collaboration and information sharing in investigation of cases.[7] The Ombudsman has thereby gained the assistance of these groups as watch-dogs in such areas as lifestyle checks on government personnel, and the integrity of government procurements, disbursements, and collection of revenues. The agreement also encourages the business groups to report instances of corruption, red tape, and mismanagement. The Ombudsman has entered agreements with other organizations in the private sector, civil society, and universities dealing with such areas as education and media programs on anti-corruption themes.[8]

A further government initiative is the National Competitiveness Council (NCC), attached to the Department of Trade and Industry. NCC's mandate is to promote national competitiveness strategies and push for the implementation of supportive policy frameworks. The NCC serves as the primary collection point of investor issues that need to be addressed in order to improve international competitiveness, collaborates with national and local government on legislative and administrative solutions, and monitors implementation.[9] There is no explicit anti-corruption agenda here, but corruption is clearly a competitiveness concern for the country and fits with NCC's mandate.

The Securities Exchange Commission (SEC) of the Philippines intervened in this area by promulgating a Code of Corporate Governance applicable to listed companies, those surpassing a minimum size threshold, and others selling shares to the public or registered with the SEC.[10] The Code states a number of governance and transparency norms, as well as standards and procedures for audit and internal control (see below).

The major non-governmental initiative on prevention of corruption involving the private sector is the Integrity Initiative.[11] This is a campaign aiming to establish integrity standards among business, government, the judiciary, civil society, the media, and others and thereby to arrest “the vicious cycle of corruption in the Philippines.” In the business community, the Initiative draws on commitments by CEOs to expand ethical practices throughout their organizations, and collective action among local and foreign enterprises to change the business culture accordingly. The Initiative has put forward an Integrity Pledge in which signatories make such commitments as these:

- Prohibiting bribery in all activities under company control, ensuring that any charitable and political contributions, business gifts, and sponsorships are transparent and not for the purpose of undue influence.
- Maintaining a Code of Conduct to guide company employees towards ethical and accountable behavior at all times, and applying appropriate sanctions for violations of the code.
- Conducting training programs for employees to promote integrity, honesty, and accountability in the exercise of their responsibilities and to convey the company’s commitment to ethical business practices.
- Implementing internal systems and controls to prevent unethical conduct by employees, and to institutionalize the values of integrity and accountability.
- Maintaining channels by which employees and other stakeholders can raise ethical concerns and report suspicious circumstances in confidence without risk of reprisal.

These commitments are fleshed out in a Unified Code of Conduct for Business. The Code includes guidelines on “tone at the top,” and due diligence with respect to using agents, giving gifts, and other potentially sensitive activities. The Code also calls for monitoring compliance and regular updating and strengthening of systems.[12]

The Office of the Ombudsman is one of 32 government agencies, including Cabinet Secretaries and heads of agencies that have signed the Integrity Initiative's Integrity Pledge. Some 1,800 companies have signed the Pledge, and some 120 business associations forming the Integrity Consortium have committed to encourage their members to join the initiative. Furthermore, three major summits have been convened and 17 forums have been held. As a follow-up to signing the Integrity Pledge, companies are conducting online self-assessments of their integrity practices and undergoing validation procedures of their results with third parties. The government has agreed to form a public-private technical working group to develop a framework and corresponding policies aimed at rewarding ethical behavior in companies.[13] Cognizant of the private sector's role in promoting good governance, the Aquino administration has made the Integrity Initiative a part of the Open Governance Partnership (OGP) program. Launched in 2011, OGP provides an international platform for domestic reformers aiming to make their governments more open, accountable and responsive to citizens – in 62 participating countries.[14]

International standard[15]	Compliance by member country
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	Significant efforts underway.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) Ombudsman provides point of contact for corruption complaints, outreach to private sector. 2) No such provision.
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) Ombudsman MOUs with business associations for information sharing on cases, serving as watch-dogs. NCC cooperation with private sector on competitiveness issues. Philippines joined the Open Governance Partnership. 2) Ombudsman cooperation with other organizations on education and media programs addressing anti-corruption themes. 3) SEC Code of Corporate Governance (large, listed, or SEC-registered companies), Ombudsman policy analysis and reform proposals. Integrity Initiative: Unified Code of Conduct for Business deals with key internal control issues related to corruption.
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	Integrity Initiative: pledge to prevent corruption and strengthen integrity, including Unified Code of Conduct for Business. Signatories include government, business, and civic institutions.

3. Internal Controls, Ethics, and Compliance

A. Internal audit

The Philippines does not generally require internal audits, although it would be difficult if not impossible for companies to meet the corporate governance and accountability requirements without such audits. In the case of large companies and those listed on the stock exchange or registered with the SEC, internal audit is subject to standards but is not mandatory in most cases. The Code of Corporate Governance (art.3(H)(iii)) states that a corporation "may establish an internal audit system that can reasonably assure the Board, Management and stockholder that its key organizational and operation controls are faithfully complied with." The audit committee establishes and oversees internal audit functions (art.3(K)(i)). Companies in specific sectors, such as financial institutions (BSP[16] Circular No.499/2005), are subject to mandatory internal audit with more stringent substantive requirements – carried out by auditors who are experienced CPAs and comply with IIA standards.

When internal audits are performed, the Code (art.5(A)(iii)) states that they should assess such matters as the effectiveness of corporate governance controls, the integrity of financial information, protection of assets, efficiency of operations, and compliance with contracts, laws, and regulations. The internal auditor is expected to comply with the International Standards on Professional Practice of Internal Auditing (IPPF). The IPPF cover professional standards as well as methods for carrying out an internal audit, and key substantive areas to be addressed such as the company's internal risk management.

Internal auditors in the Philippines do not have mandatory professional standards, but do have a professional institute that promotes good practice. The Institute of Internal Auditors of the Philippines (IIA-P) is a voluntary professional development and standard-setting body that uses the global IIA standards and code of ethics. The organization seeks to ensure adherence to the IIA norms, works to develop the profession, provides continuing education, and offers examinations for internal auditor certification.[17]

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	Not clear. Internal audit not required of non-financial companies.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect "illegal acts" in the books and records of companies, including bribery and other forms of corruption.	1) Membership in professional body is voluntary, except for internal auditors of financial institutions (BSP Circular No.499/2005). 2) IIA-P follows international (IPPF) standards, which include this duty. Corporate Governance Code requires internal audit to follow IPPF standards (large, listed, or SEC-registered companies).
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	1) Mandatory internal audit applies only to financial institutions (BSP Circular No.499/2005). Corporate Governance Code defines standards and procedure for internal audit. 2) and 3) Code includes within scope of internal audit: internal governance controls, legal-regulatory compliance. 4) Audit committee establishes and oversees internal audit function, per CG Code.

B. Audit committee

The Corporate Governance Code (art.1) requires the boards of directors of all companies to which the Code applies (i.e. listed, large, or SEC-registered) to establish an audit committee. The audit committee must include three directors, of whom at least one must be an independent director and one must have audit experience. The committee assists the corporate board in oversight of financial reporting, internal controls, audit, and compliance with laws and regulations. It also monitors the quality of the internal control system (art 3(K)(i)).

SEC Memorandum Circular No. 4/2012 (arts.1-5) provides guidelines, applicable to listed companies only, for the duties and functions of the audit committee. The latter is responsible for oversight in such areas as financial reporting and disclosures, risk management and internal controls, internal and external audit. The committee should have a charter addressing these obligations. The committee has a duty to monitor and evaluate the effectiveness of the internal control system including financial reporting, information technology security, the framework for fraud prevention and detection, and management's activities in managing risks and promoting risk awareness in the company. The SEC Circular provides detailed rubrics for each category of standards and duties, and on this basis, the committee is to perform self-assessments. Companies' annual reports to the SEC must disclose whether they in fact have audit committees, and how the latter have carried out their responsibilities.

<table>
<tr><th>International standard</th><th>Compliance by member country</th></tr>
<tr><td>1) Encourage or require companies to establish audit committees (or equivalent).
2) Committee members to include:
• Financial experts.
• Independent directors.</td><td>Per Corporate Governance Code:
1) Audit committee required for large, listed or SEC-registered companies.
2) Three-member committee must have one independent director, one with audit experience.</td></tr>
<tr><td>Audit committee terms of reference:
1) Supervise accounting methods, internal and external audit.
2) Review internal controls and ethics code, compliance of directors, managers, employees, and agents.
3) Guidance to staff on compliance and on preventing corruption.
4) Respond effectively to information on possible corruption.
5) Provide confidential channel of communication for reports of suspected irregularities, corruption.</td><td>1) and 2): Included in audit committee scope for large, listed, or SEC-registered companies including financial institutions (Corporate Governance Code, SEC Circular No. 4/2012.
3) No requirement.
4) and 5): Appropriate handling of complaints and follow-up required for financial institutions (BSP Circular No.499/2005).</td></tr>
</table>

C. Internal control and compliance systems

In the Philippines, businesses in general are encouraged by the Integrity Initiative to establish internal control systems. The extent to which this standard is followed in practice is unclear, as data are not available. The Office of the Ombudsman notes that some Integrity Initiative signatories have submitted self-assessment reports that show the use of internal controls. Regulatory authorities, above all the SEC, include internal control system requirements in their rules for certain types of companies.

Thus, the SEC's Corporate Governance Code (art. 3(H)) provides regulatory guidance on the design of internal controls, including the designation of a responsible compliance officer (for large, listed, or SEC-registered corporations). The Code describes the corporate control environment as consisting of direction and oversight by the board and management, with effective management supporting such systems as organizational and procedural controls, information and risk management processes, and an independent audit function.

In its Memorandum Circular No.5/2013, the SEC requires listed companies to submit annual reports on corporate governance in the format provided. The Circular (art.G) requires the reporting company to explain how its internal control system is defined, to state whether the directors have reviewed the internal control system, and to indicate whether they have found it to be effective or not.

The SEC's Corporate Governance Code (art. 3(H)) stipulates a set of minimum control mechanisms for relevant firms (large, listed, or SEC-registered companies). These include definitions of the duties and responsibilities of the CEO and senior managers, assuring there is competent management staff overall, and review of the company's human resource policies including conflict of interest controls and employee compensation programs. The Code recognizes that the details of these systems will vary with the size and complexity of the enterprise, and stresses the importance of internal audit as a check on these control systems.

The Securities Regulation Code (art.22.2) requires certain companies[18] to maintain a system of internal accounting controls sufficient to provide reasonable assurance that:

- Access to assets is provided only pursuant to management authorization, and recorded assets are compared with actually existing assets at reasonable intervals; and
- Financial statements are prepared in conformity with the applicable accounting principles and financial reporting standards.

In a similar vein, BSP's regulations include rules on financial statements, internal audit, and internal control systems for banks.

These provisions could do more to reinforce commitments to ethical norms and prevention of corruption across the whole company. Nor do they explicitly address bribery or other forms of corruption, or more specific aspects of this such as exchange of gifts or retention of third-party agents.

The Code of Corporate Governance (art.11) does provide for enforcement through administrative sanctions. Fines of up to PHP 200,000 (USD 4,560) may be imposed for every year that a covered corporation violates the provisions of the Code (without prejudice to other sanctions that the Commission may be authorized to impose).

International standard	**Compliance by member country**
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees. 4) Risk-based approach: • Individualized assessment of risks to the enterprise, including corruption risks. • Regular monitoring and re-assessment of corruption risks.	1) Listed companies required to disclose and explain internal controls (SEC Circular No.5/2013). 2) Audit committees must oversee internal control functions of large, listed, and SEC-registered firms (Corporate Governance Code, SEC Circular No. 4/2012). 3) No requirement. 4) Audit committee has a duty to monitor and evaluate internal controls including fraud prevention and detection, and management of risks and promoting risk awareness in the company (SEC Circular No. 4/2012).

Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements. 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations. 4) Require for third-party representatives, consultants, or agents: • Written contract, adherence to company ethics standards and anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	Large, listed, SEC-registered companies: 1) Compliance with laws, regulations, and codes of conduct to be monitored by internal audit (Corporate Governance Code). 2) Controls required for conflicts of interest and related matters (Corporate Governance Code). 3) No requirement. 4) No requirement.
Enforcement, including sanctions for failure to comply.	Per Code of Corporate Governance, fines of up to USD 4,560 may be imposed for every year that a covered corporation violates the Code.

4. Integrity of Financial Statements

A. Accounting

1. Financial records

The National Internal Revenue Code (arts.232-235)[19] provides basic standards for the form and preservation of accounting records. All corporations, companies, partnerships or persons required by law to pay internal revenue taxes are required to keep a journal and a ledger. Persons whose sales, receipts or output falls below a threshold (in the Code PHP 50,000 or USD 1,100) may use a simplified set of bookkeeping records (as authorized by the Secretary of Finance) that show transactions and results of operations, and from which tax liability can readily be assessed. Businesses may also keep “subsidiary books” as needed, but the latter must be part of the accounting system of the taxpayer and are subject to the same rules applicable to the journal and ledger. All the books of account, including the subsidiary books, are subject to examination and inspection by internal revenue officers. Other accounting records must also be preserved, including the corresponding invoices, receipts, vouchers and returns, and other source documents supporting the entries in the books of account.

The Revenue Code requires these books and records to be maintained for three years, but a regulation adopted in 2013 extends the retention period to ten years in the case of a fraudulent return or failure to file a return.[20] As a result, the Commissioner of the Bureau of Internal Revenue (BIR) is requiring all taxpayers to preserve their books of account, including subsidiary books and other accounting records, for a period of 10 years. Both the taxpayer and the CPA who audited the records and certified the financial statements of the taxpayer have a duty to retain the certified financial statements for a period of 10 years. Further, anti-money laundering rules adopted by the Securities and Exchange Commission require regulated entities to retain transaction records, including customer identification data, for five years.[21]

Last, the Philippine Revised Penal Code criminalizes falsification of documents, as well as the use of such falsified documents. The prohibition is understood to include accounting and tax records.[22]

International standard	Compliance by member country
Record-keeping and disclosure: 1) Required form, method, and minimum time period for retention of financial records. 2) Applicability: All legal entities must comply. If not, which companies?	1) and 2): All businesses subject to tax must keep account books, though simplified records can be kept by micro-enterprises. Retention period is 3 years by law, extended to 5 years by SEC rules and ten years by BIR regulation.
Prohibitions (UNCAC 12(3), OECD Convention 8(1), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	1) The Philippine Revised Penal Code penalizes Falsification of Public and Private Documents, as well as the use of such falsified documents. 2) BIR and SEC retention periods in effect prohibit premature disposal or destruction. 3) and 4): “Subsidiary” books must be part of the same accounting system and are subject to the same rules per Internal Revenue Code. 5) and 6): No specific prohibition, but generally covered by Penal Code prohibitions on false documents.

2. Financial reporting requirements

Philippine standards on financial reporting are now fully converged with International Financial Reporting Standards (IFRS), with minor exceptions. The Financial Reporting Standards Council (FRSC), established under the Accountancy Law regulations, is implementing the policy adopted by the Accountancy Board and PICPA to converge Philippine accounting standards with IFRS. The FRSC monitors the technical activities of the IASB and invites comments on exposure drafts of proposed IFRS as these are issued by the IASB. When finalized, these are adopted as Philippine Financial Reporting Standards (PFRSs) by the Board. The FRSC has also issued implementation guidance on PFRSs.[23]

The SEC, in its SRC Rule 68 [24] (arts.1-2), states the scope of application of the accounting and financial reporting standards. Large or “publicly accountable” companies are required to use PFRS as their financial reporting framework (with limited exceptions). This category of institutions includes publicly owned corporations with total assets of more than PHP 350 million (USD 7.8 million) or total liabilities of more than PHP 250 million (USD 5.6 million), and companies that are listed or have otherwise sold certain types of equity holdings.[25] Below this level, SMEs are to use as their financial reporting framework the PFRS for SMEs, based on the equivalent IFRS for small-medium businesses (certain of these firms are allowed to continue using regular PFRS). SMEs are defined as businesses (not listed on the stock exchange) having total assets or liabilities of at least PHP 3 million (USD 67,000). (Consolidated figures are to be used if the entity is a parent company.) Finally, below this level are micro-businesses, which may use PFRS for SMEs or the older GAAP standards with a few key PFRS-required documents.

The Corporate Governance Code (art. 8), requires that "all material information about the corporation which could adversely affect its viability or the interest of the stockholders should be publicly and timely disclosed." SEC rules and circulars provide more detail.[26] A "material misstatement" occurs when accounting policies do not comply with PFRS (or GAAP for micro firms) or are applied inconsistently, when estimates or assumptions used on a significant account are unreasonable, when financial statements are not presented on a consolidated basis where this is required, and a few other circumstances.

International standard	Compliance by member country
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) Required to use IFRS (PFRS): large or publicly accountable companies. 2) SMEs to use PFRS for SMEs; microenterprises to use GAAP. 3) Consolidated disclosures for subsidiaries 50% or more owned; summary information on other affiliates.[27]
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) Disclosure of material contingent liabilities required per IFRS/PFRS. Information that can adversely affect interests of shareholders is material.[28] This does not normally require disclosure of future effects of corruption. 2) No explicit prohibition.

B. Audit

1. Auditing requirements

Tax and company laws provide basic audit rules, with SEC regulations setting additional standards for particular categories of firms. The National Internal Revenue Code (art.232) requires all businesses with sales or output surpassing a defined threshold (in the Code PHP 150,000 or USD 3,400) to have their books of accounts audited annually by a CPA. The Corporations Code (art.75) requires independent external audits for large[29], stock exchange-listed, and SEC-registered companies. For other corporations, it is sufficient for the financial statements to be certified by a corporate officer.

The SEC, under SRC Rule 68 (art.3), requires companies to submit financial statements accompanied by an independent auditor's report. For this purpose, the companies must use external auditors duly registered with the BOA, or be subject to fines. Certain corporations must have independent external auditors accredited by the SEC. These are most public companies listed on the stock exchange, issuing registered securities, or meeting a size threshold[30]– as well as most financial institutions and investment companies.

Under Rule 68 (arts.3B, 3E), a company's external auditors must report to the audit committee or board of directors, discuss any adverse findings, and record explanations provided in response by management. Within five days of receiving the report, the company must report to the SEC its actions taken with respect audit problems, including material findings based on fraud or error, and material weaknesses in internal control. The companies meeting the SEC size and listing thresholds (preceding paragraph) must submit these reports to the SEC in a defined format, signed by the chairman of the board or chairman of the audit committee.

International Standards on Auditing (ISA) have been incorporated as the Philippines Standards on Auditing (PSA).[31] As in other ISA jurisdictions, the auditor should gain an understanding of the company's accounting policies, assess the control risk environment, and test the internal controls in order to detect material misstatements and counteract the associated audit risks (ISA/PSA 400). Further, audit reports must address risks of fraud or non-compliance with laws leading to material misstatements (ISA/PSA 240 and 250).

The Philippines' current version of ISA 250 (PSA 250 (Redrafted)), provides more specific guidance than the ISA for auditors who identify possible non-compliance with laws and regulations, including corruption. According to the standard, indicators of non-compliance with laws and regulations include the following:

- Investigations by regulators or government departments, or payment of fines or penalties.
- An information system that fails to provide an adequate audit trail.
- Unauthorized or improperly recorded transactions.
- Payments that are out of the ordinary, such as for unspecified services or loans, commission agent fees that appear excessive, unusual payments in cash or bearer instruments, and transactions with companies registered in tax havens.

The auditor should analyze the likely impact of failure to comply with laws and regulations, addressing such potential financial consequences as the imposition of penalties or damages, expropriation of assets, and enforced closure. The auditor should consider whether such consequences make the financial statements misleading, and if they require disclosure.[32]

Company management and boards of directors must certify their audited financial statements before submitting them to the shareholders (and eventually to the SEC). Rule 68(2B) includes a "Statement of Management's Responsibility for Financial Statements" that must be included. The statement attests that the accounts were prepared according to the correct standards and provide a fair presentation of the financial position, free from material misstatement. It must be signed by the Chairman of the Board, Chief Executive Officer, and Chief Finance Officer (for the largest category of publicly accountable companies, signatures must be under oath).

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	Yes, at least for large and listed companies regulated by the SEC.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	1) All businesses with sales/output above USD 3,400 require independent audits (Revenue Code art.232). Large and listed firms: accredited auditors, submit audit reports to SEC (SRC Rule 68 (art.3)). 2) Lesser requirements below SEC and tax thresholds.
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	Philippines has adopted ISA, including 240 and 250. PSA 250 exceeds ISA standard, requiring analysis of audit issues relevant to corruption.
Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks. 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	1) Certification, audit opinion, and documented testing of internal controls all required for large and listed companies per PSA. 2) Certification, signature of financial statements by Chairman, CEO, and CFO for large and listed companies (SRC Rule 68(art.2)).

2. Auditor reporting of improprieties

The SEC rules impose a duty to report illegalities and corruption, and provide a "safe harbor" for auditors releasing certain information on these matters. In terms of internal reporting, SRC Rule 68 (art.3E, see above) requires the external auditor to report adverse findings and discuss them with the audit committee or board of directors. The company in turn must report to the SEC all findings of material problems, and the actions taken to address them. The findings must include any instances of the following:

- Material findings involving fraud or error.
- Significant losses or potential losses and actual or impending insolvency.
- Material internal control weaknesses which may lead to financial reporting problems.

If the company does not submit a report on these matters to the SEC within 30 days, the external auditor is to file her/his own report to the Commission. The Rule requires the company's contract with the external auditor to include a safe harbor provision as follows: "the disclosure of information by the independent auditor to the Commission shall not constitute a breach of confidentiality nor shall it be a ground for civil, criminal or disciplinary proceedings against the independent auditor."[33]

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	Auditor to discuss with board of directors or audit committee any findings of fraud, error, internal control weaknesses, potential for significant loss or insolvency, that are material (adverse effect on financial position or shareholder interests, SRC Rule 68 (3E)).
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").	1) Company must submit signed audit report, containing adverse findings, to SEC within 30 days. Failing this, the auditor must forward original audit report to the SEC. 2) Mandatory safe harbor provision in company agreement with external auditor.[34]

C. Professional standards and independence

The Philippines has a well-developed governance and standard-setting structure for the accounting profession. The Accountancy Law (arts.3-9) provides for the standardization and regulation of accounting education, including CPA examinations. It sets up a professional regulatory board, the Board of Accountancy (BOA), with authority to set rules, to supervise registration and licensing, and to adopt an ethics code. The Board (with approval of the SEC) promulgates accounting and auditing standards, which must include international accounting and auditing standards. The Rules and Regulations under the Accountancy Law (art.9) require the establishment of a council on accounting and audit standard-setting – a responsibility now carried out by separate bodies on accounting and auditing (see below).[35] Practicing accountants are required to be members of the Philippines Institute of Certified Public Accountants (PICPA). PICPA developed the Code of Ethics for Professional Accountants, based on the IFAC model, for enactment by the Board.

The SEC's Code of Corporate Governance (arts.2 to 5)[36] defines an independent auditor as an auditor who fully meets the requirements of independence provided in the Code of Ethics for Professional Accountants in the Philippines. Public companies registered with the SEC must use auditors accredited by the Commission, while large[37] and listed companies require the auditor's firm to be accredited as well. For SEC accreditation, auditors must be credentialed by the Board of Accountancy (BOA), have at least five years' experience directing external audits, and have quality control systems in place (per PSA 220) in their practice.[38] The BOA monitors the quality of financial statement audits (Accountancy Law (art.9(h)), applying IAASB standards including the ethics code of the affiliated IESBA.[39]

The regulations also include provisions to reduce the risk of conflict of interest and undue influence. SRC Rule 68 (Art.3 B) requires the rotation, every five years, of the independent auditors or in the case of an audit firm, the signing partner (with a two-year cooling off period in-between). Further, the SEC's Circular No.13/2009 (art.9) restricts the external auditor's and firm's non-audit work for the audited firm. Such work as the following cannot be performed unless safeguards (stipulated in the PICPA Code of Ethics) are in place: bookkeeping, financial information systems design or implementation, internal audit, management functions, brokerage or investment advice.

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) Board of Accountancy governs the profession and sets standards with SEC approval. 2) PICPA developed a code based on IFAC, which was enacted by the Board.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	1) All firms above minimal sales threshold to have external audit by CPA. Large and listed firms: appointment from among BOA/SEC-approved auditors (SEC Circular no.13/2009, Revenue Code). 2) External auditor's non-audit work for firm must meet ethics standards (PICPA) or is prohibited (SEC Circular No.13/2009). 3) Auditor to rotate after 5 years (2-year cooling-off period) (SRC Rule 68 (Art.3 B)). 4) and 5): BOA and PICPA restrictions.
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) Firms above minimal sales threshold to have external audit by CPA. Large and listed firms must use SEC-accredited auditors having BOA credentials and quality-control systems (SEC Circular no.13/2009, Revenue Code). 2) BOA sets training standards. 3) BOA monitors auditors per IAASB standards. 4) BOA and SEC impose fines and other disciplinary measures (see *Enforcement*, below).

D. Enforcement

The SEC is the lead enforcement agency here, although the Board of Accountancy has a role in disciplining accountants, and sector authorities such as BSP impose sanctions on companies within their jurisdiction. The main penalties decreed by the SEC apply to corporations themselves.

The SEC's Corporate Governance Code sets fines of up to PHP 200,000 (USD 4,500) for financial reporting violations, which may involve both accounting and audit standards. SEC rules[40] specify the offenses of "material deficiency" and "material misstatement." The former is the submission of a non-compliant report missing certain key components, and the latter a substantive misrepresentation due to the use of incorrect (or inconsistently applied) accounting standards, failure to disclose material information, and other causes. A range of penalties is provided, the actual fines depending on business volume, whether a first or later offense, and other factors. Offending companies may be liable for up to PHP 200,000 (USD 4,500)[41] or 0.4% of the amount of the misstatement (whichever is higher). Further, the Revised Penal Code penalizes falsification of documents, with imprisonment ranging from six months to twelve years, and fines of up to PHP 5,000 (USD 114). The use of falsified documents is also penalized with imprisonment ranging from one to six months.[42]

The Accountancy Law provisions apply to individuals and firms. Anyone violating the Law or related BOA rules is punishable by a fine of not less than PHP 50,000 (USD 1,100) or imprisonment for up to two years, or both.[43] Further sanctions are stipulated in Rule 68 (Part II Art 10) and SEC Circular No.13/2009 (art. 11-12) for independent auditors and auditing firms, including:

- Failure to submit any of the required reports or documents requested documents in connection with an ongoing investigation.
- Gross negligence in the conduct of the audit or failure to comply with any of the PSAs or related rules of the AASC and SEC.
- Issuance of an unqualified opinion where the audited firm did not comply with the applicable financial reporting framework due to a material deficiency or misstatement.
- Conduct of an audit despite the lack of appropriate accreditation or safeguards for independence.

A scale of fines is provided for the different offenses listed above, based on the category of audited company, first or later offense, etc. Thus, for example, for material deficiency or misrepresentation, the fine for the auditor or audit firm is set at 50% of the amount that may be imposed on the audited company for the same offense (see above). Where a company uses auditors or audit firms that are not properly accredited, fines for the auditors run from PHP 10,000 to 400,000 (USD 228 to USD 9,100), and for the audited companies PHP 25,000 to 100,000 (USD 570 to USD 2,200). In addition, auditors who fail to pay the fines may have their accreditation suspended or revoked.

International standard	Compliance by member country
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2): Unclear. Offenses are appropriately defined, but penalties may be too low. Strength of enforcement in practice is unclear, absent case statistics.
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) and 2): Offenses are subject to fines, imprisonment, and revocation of license for accountants and auditors; fines up to maximum fixed amount or percentage of misstatement for companies. 3) SEC, BOA, Company Registrar, or revenue authority may impose fines or de-licensing.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	Same as above.

5. Conclusion and Recommendations

A. General efforts to prevent corruption involving the private sector

Government and civic initiatives to build public-private cooperation in this field and to reinforce values of transparency and integrity are impressive. These include efforts of the Ombudsman and the Integrity Initiative, along with the codes of conduct that have been developed. And yet, the Philippines continues to suffer from substantial corruption involving business – although there are indications that this is improving.

Recommendations

1) Adopt penal provisions on sentence mitigation for self-reporting of corruption offenses and preventive steps to mitigate corruption risks.
2) The Ombudsman and the Integrity Initiative should consider promoting corruption prevention as a concern or duty of the accounting and audit professions.

B. Internal Controls, Ethics, and Compliance

The Philippines has a comparatively well-developed set of rules on internal control and compliance. Internal audit, audit committees, and internal control systems are all required for certain categories of companies. Internal audit is required only in the sector where it appears most necessary, i.e. in financial institutions, while the others apply to large and/or listed companies.

Recommendations

1) Consider making internal audit mandatory for a wider range of companies, and bringing it under more specific substantive, procedural, and professional norms. In particular, consider providing internal auditors with explicit duties with respect to preventing and detecting corruption.
2) Require internal control systems to include procedures for strengthening commitment to integrity and prevention of corruption across the company.
3) Require internal control systems to provide specific guidance on gift-giving and retention of third-party agents.

C. Integrity of Financial Statements

In this field, the Philippines has put relatively strong regulatory frameworks in place. It has converged its standards with IFRS and ISA, including the special IFRS for smaller firms. Accountant and auditor professional standards are set reasonably high, and a robust structure of professional monitoring bodies enforces them. External auditors are required to ensure that reports of adverse findings including illegalities and other material improprieties are submitted to the SEC – and where necessary can provide this report on their own. In this, the auditors are protected from liability for breach of confidentiality.

Recommendations

1) Consider a research effort to determine the effects of requirements that are more stringent than in general international practice, such as the submission of adverse audit findings to the SEC, the safe harbor provision in external auditor contracts, and external audits required of small companies. While these standards are quite positive in principle, it would be not only instructive but useful to determine if they achieve their goal, and are proportional.
2) Fines, especially for companies, should be revisited. At the highest levels they could be substantial (depending on the value of a material misstatement), but in general they appear too low to be dissuasive.
3) Keep publicly-available statistics on private sector compliance and state enforcement actions in this area.

Philippines Laws, Regulations, Policy Documents Referenced:

BSP Circular No.499/2005 on Audit Committee and Internal Audit Function.

Code of Ethics for Professional Accountants in the Philippines, 2004, Board of Accountancy.

National Internal Revenue Code http://www.bir.gov.ph/taxcode/taxcode.htm#nirc_outline

Philippine Accountancy Act, No.9298 of 2004.

PSA 240 (Redrafted), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements,* AASC.

PSA 250 (Redrafted), *Consideration of Laws and Regulations in an Audit of Financial Statements,* AASC.

Rules and Regulations Implementing Republic Act No.9298 (Accountancy Act of 2004), Board of Accountancy, 2004.

SEC Memorandum Circular No. 4/2012, Guidelines for the Assessment of the Performance of Audit Committees of Companies Listed on the Exchange.
SEC Memorandum Circular No.5/2013, Corporate Governance Report.
SEC Memorandum Circular No.6/2009, Revised Code of Corporate Governance.
SEC Memorandum Circular no.8/2009 on the Scale of Fines for Noncompliance, http://www.sec.gov.ph/laws/memorandumcircular/CY%202009/sec-memo-08,s2009.pdf.
SEC Memorandum Circular No.13/2009, Revised Guidelines on Accreditation of Auditing Firms and External Auditors, http://www.sec.gov.ph/laws/memorandumcircular/CY%202009/sec%20memo%20no.%2013,s2009.pdf.
SRC Rule 68, as Amended, http://www.sec.gov.ph/accountantsinfo/irr/SRCRULE68-Revisedversion2011.pdf.

NOTES

1 http://www.bti-project.org/country-reports/aso/phl.
2 http://www.bti-project.org/country-reports/aso/phl.
3 http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/philippines/general-information.aspx
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5 *Id.*
6 http://www.lawphil.net/statutes/repacts/ra1989/ra_6770_1989.html.
7 United Nations (2012), "Implementation of Article 12 of the United Nations Convention against Corruption," CAC/COSP/WG.4/2012/2, p.10.
8 www.ombudsman.gov.ph/index.php?home=1&navId=Ng==&subNavId=NTE=&sub2NavId=NjI=&projId=MTE=&disp=1
9 http://www.competitive.org.ph/files/downloads/EO_no._44.pdf, http://www.gov.ph/2006/10/05/executive-order-no-571-s-2006/ .
10 Revised Code of Corporate Governance, SEC Memorandum Circular No. 6, 2009. The size threshold is: assets in excess of P50 million (USD 1.1 million) and at least 200 stockholders each owning at least 100 equity shares. The Code applies to some additional categories of firms as well, but the main ones have been noted. http://www.lawphil.net/statutes/repacts/ra2000/ra_8799_2000.html.
11 http://integrityinitiative.com/pdf/Integrity-Pledge.pdf
12 http://integrityinitiative.com/pdf/Unified-Code-of-Conduct-for-Business.pdf.
13 http://integrityinitiative.com/making-integrity-everyones-business; government comments.
14 http://integrityinitiative.com/events/3rd-integrity-summit

[15] The sources of all standards are provided in footnotes to the tables presented in the section of the Review entitled *International Standards for Country Reports.*
[16] *Bangko Sentral ng Pilipinas*, the central bank.
[17] http://www.iia-p.org/
[18] Companies that have issued securities beyond a defined threshold, and issuing companies with assets of P50 million (USD 1.1 million) or more and at least 200 substantial equity holders.
[19] http://www.bir.gov.ph/taxcode/taxcode.htm#nirc_outline
[20] In such cases, both the tax assessment and record retention periods are extended to ten years; the Commissioner of Internal Revenue and the taxpayer may also agree to extend the assessment period beyond this limit, and this extends the retention period accordingly. Bureau of Internal Revenue, Revenue Regulations, No. 17-2013. Government comments.
[21] *Anti-Money Laundering Operating Manual For Covered Institutions*, SEC Memorandum Circular, sec. 5.1-5,2, http://www.sec.gov.ph/laws/memorandumcircular/CY%202002/secMemo1/chapter_5.html. The records must enable the SEC to reconstruct the relevant transaction and compile an audit trail for suspected money laundering. Government comments.
[22] Government comments.
[23] http://www.picpa.com.ph/Philippine-Financial-Reporting-Standards/About-FRSC.aspx
[24] Securities Regulation Code Rule 68, as Amended, http://www.sec.gov.ph/accountantsinfo/irr/SRCRULE68-Revisedversion2011.pdf.
[25] The Rule (Part II art.9) requires large or publicly-accountable companies to include summary financial information on non-consolidated subsidiaries.
[26] SEC Circular no.8 2009 (art.III), http://www.sec.gov.ph/laws/memorandumcircular/CY%202009/sec-memo-08,s2009.pdf; SRC Rule 68 (Part II, art.10(B)).
[27] SEC, SRC Rule 68 (arts.1-2).
[28] Corporate Governance Code (art. 8); SEC Circular no.8 2009 (art.III); SRC Rule 68 (Part II, art.10(B)).
[29] More than PHP 50 million (USD 1.1 million) in total assets.
[30] Total assets of PHP 50 million (USD 1.1 million) or more (with 200 or more substantial owners).
[31] http://www.aasc.org.ph/downloads/aasc/publications/preface-to-philippine-standards.php; http://www.aasc.org.ph/downloads/PSA/PSA.php .
[32] http://www.aasc.org.ph/downloads/PSA/PSA.php. PSA 240, a standard that is at least equally important in preventing corruption, appears essentially the same as ISA 240.
[33] These rules were announced in SEC Memorandum Circular No.13/2009, Revised Guidelines on Accreditation of Audit Firms and External Auditors, and incorporated in the most recent amended version of Rule 68.
[34] SRC Rule 68 (3E). Applicable to listed, SEC-registered, and large companies (total assets of USD 1.1 million or more, with 200 or more substantial owners) as well as most financial companies.
[35] http://www.prc.gov.ph/prb/?id=1&content=1
[36] As well as SRC Rule 68 (art.3).
[37] Assets of P50 million (USD 1.1 million) or more and 200 or more owners of sizeable blocks of shares.

[38] SEC Memorandum Circular No.13/2009, http://www.sec.gov.ph/laws/memorandumcircular/CY%202009/sec%20memo%20no.%2013,s2009.pdf. Audit firms must meet similar standards for SEC accreditation, http://www.sec.gov.ph/accountantsinfo/auditingfirm.html.

[39] International Ethics Standards Board for Accountants. The Auditing and Assurance Standards Council (AASC), established under the Accountancy Act, assists the BOA in establishing audit standards. http://www.aasc.org.ph/.

[40] SRC Rule 68 (Part II art.10); SEC Circular No.8/2009, http://www.sec.gov.ph/laws/memorandumcircular/CY%202009/sec-memo-08,s2009.pdf.

[41] The maximum is much lower (P16,000 or USD 360) for non-public companies.

[42] Revised Penal Code of the Philippines, Article 171-172.

[43] Accountancy Law (art.36), http://www.prc.gov.ph/uploaded/documents/Accountancy%20Law.pdf.

Samoa

1. Introduction

Samoa, an archipelago of nine islands in the south-west Pacific, has a small economy that relies on remittances from Samoans living overseas as well as subsistence agriculture. The agriculture sector accounts for some 10% of GDP and over 65% of the labor force. The economy is diversifying, with growth in manufacturing, the fisheries sector, tourism, and the offshore financial sector. The fisheries sector accounts for roughly over 40% of the value of exports. Tourism is an expanding sector accounting for 25% of GDP. Still, the economy is strongly affected by weather-related disasters and shifts in global commodity prices. Samoa's population of some 195,000 enjoys very high literacy, at nearly 99%, and a GNI per capita of about USD 3,000. New Zealand and Australia, followed by the US, provide the bulk of overseas employment and development aid to Samoa.[1] According to the World Bank Group, Samoa has one of the best investment climates in the East Asia-Pacific region, including a score of 6.3 out of ten on the Strength of Investor Protection Index. There is no formal domestic stock market.[2]

Independent since 1962, Samoa is a parliamentary democracy. The head of state, who is elected by the 49-member Legislative Assembly, appoints the prime minister. The *matai*, or chiefs of extended families, make up the Assembly, and control local government and churches as well. The judiciary is understood to be independent, with a Supreme Court having jurisdiction over constitutional matters and appeals. Civil rights, including media freedom, are generally respected. The Samoan Reform Commission in 2012 recommended creation of a self-regulating media council to set standards for accuracy and balance in the news media, and protections for journalists. The recommendation was not followed up, but the government monopoly on phone and internet services was ended, and Samoa launched the first internet-based television station in the South Pacific.[3]

2. General efforts to prevent corruption involving the private sector

Instances of official corruption and abuse of office have reportedly led to increasing public discontent. In 2012, local media published an anonymous letter to the prime minister alleging corruption in the police force. An internal investigation by the police continued inconclusive into 2013. Samoa has an Audit Office that oversees performance and integrity in the public sector, as well as a recently-established Ombudsman that handles complaints concerning human rights and good governance.[4] In short, Samoa does not appear to have significant state or civic organizations cooperating to check corruption, and there are weaknesses in its protection of citizens and journalists who take a stand on public matters such as corruption. Yet, the country does appear to have the basic constitutional structures and mechanisms in place to correct abuses over time. The safeguards and systems could be improved, of course.[5]

International standard[6]	**Compliance by member country**
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	Political and legal mechanisms seem largely to work adequately, but no significant initiatives focused on corruption – particularly in the private sector.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) Ombudsman has an online complaint portal, and handles good governance and human rights matters. 2) No known initiatives.
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) through 3): No known initiatives. Government follow-through on media and police corruption matters appears to be slow. No codes on corporate governance or private sector ethics standards.
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	Integrity pacts do not appear to be used.

3. Internal controls

A. Internal audit

Samoa appears to have no legal requirements concerning internal audit. Internal audit as such is not mentioned in corporate or banking laws. There is no stock exchange in the country, and thus no listing requirements. Foreign investors, including banks such as Westpac and ANZ, would have to meet their home-country requirements in this area, and so presumably carry out internal audits

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	These controls exist in some businesses such as foreign banks but are not required in Samoa.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect “illegal acts” in the books and records of companies, including bribery and other forms of corruption.	1) and 2): No such standards.
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	1) through 4): No legal or code requirement.

B. Audit committee

In Samoa, there appears to be no requirement of an audit committee or similar body for companies in the private sector. The Companies Act[7] (art.46) places authority for management of a company's business affairs in the hands of its directors, permitting them to delegate their powers to a committee of directors or an individual (to whom the Act's relevant procedures apply). This provision enables the establishment of committees but does not require it. There is nothing further on this in the banking legislation. However, state-owned enterprises are required by the Public Bodies Act, 2001, to establish audit committees and implement guidelines on their role and composition. According to the IMF, compliance has been uneven. Reporting and disclosure requirements have been followed, but officials of government and the parliament continue to be appointed to SOE boards contrary to the law. While audit committees have been set up in many SOEs, few such committees are fully operational.[8]

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	1) and 2): Per Companies Act, corporations are able to establish committees and delegate directors' functions to them. But audit or other committees not required. Public Bodies Act does require audit committees for SOEs, but few are operational.
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers, employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	1) through 5): No requirements other than those for SOEs.

C. Internal control and compliance systems

No general legal requirement concerning internal control and compliance systems applies to companies in Samoa. However, banks and financial institutions are required to establish such systems under the Financial Institutions Act.[9] Accounting and internal control systems are considered by the Central Bank's supervisors in issuing licenses and in examining the operation and management of a financial institution under the Bank's prudential standards (arts.6, 9). The Central Bank may also require an institution to submit periodic returns, attested by an independent auditor, reporting on its compliance with internal control and other requirements – or to impose fines for failure to comply (art.9).

International standard	Compliance by member country
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees. 4) Risk-based approach: • Individualized assessment of risks to the enterprise, including corruption risks. • Regular monitoring and re-assessment of corruption risks.	1) No general legal requirement for companies to have internal controls. Per Financial Institutions Act, banking companies must report on internal control and accounting systems in license application and prudential returns. 2) Financial institutions to have at least basic controls on accounting and financial reporting. Central Bank may tighten requirements for larger or riskier institutions. 3) and 4): No requirement.
Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the	1) Per Financial Institutions Act, compliance with laws and standards affecting financial statements is very likely to be

integrity of financial statements. 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations. 4) Require for third-party representatives, consultants, or agents: • Written contract, adherence to company ethics standards and anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	required by prudential oversight. 2) through 4): No requirement.
Enforcement, including sanctions for failure to comply.	Per Financial Institutions Act: Central Bank may impose fines for failure to report on internal controls and other matters as required.

4. Integrity of financial statements

A. Accounting

1. Financial records

Samoa imposes record-keeping requirements on businesses through tax and company legislation. The Income Tax Act [10] (art.119) requires enterprises to keep records sufficient to assess net income and expenses for at least 12 years. “Records” include books of account (records of receipts, payments, purchases, sales, etc.) as well as vouchers, invoices, receipts, and such other documents necessary to verify the entries in the books of account. Failure to comply is an offense.

The Companies Act (arts.117-119) lists several kinds of records that companies must keep for at least seven years, including: rules, minutes, communications with groups of shareholders, accounting records, and financial statements. The records must be kept in hard copy or a form readily convertible to written form. Directors must ensure that adequate measures are in place to prevent and detect falsification of the records. These records are to be kept in the registered office in Samoa, or another place (including overseas) with prior notice to the Company Registrar, and provided that sufficient documents and returns are kept in Samoa to enable accurate disclosure of the company's financial situation at six-month intervals and to prepare financial statements. The records (art.129) must correctly record and explain the company's transactions. They must also enable accurate determination of the company's financial position, compliance with financial reporting requirements, and external audits to be readily and properly done. The records must contain details on all amounts spent and received, purposes and receipts for transactions, stock held, and in some cases (small retail) daily cash totals rather than receipts. Failure to comply is subject to fines.

The Companies Act (arts.340, 342) also addresses false statements and manipulation of records. Offenses here include wilfully making or authorizing a statement in an accounting document that is "false or misleading in a material particular"(including by omission). It is also an offense for a company director or employee to make, authorize, or permit such a statement concerning the affairs of the company and directed to company directors, employees, auditors, holding company officers, shareholders, creditors, trustees, receivers, or liquidators. In addition, it is an offense for a director, employee, or shareholder to destroy, alter, or make a false entry in any company register, accounting record, or other documents with intent to defraud or deceive. This includes manipulating or falsifying electronic records as well. These offenses are subject to much heavier fines, as well as imprisonment.

International standard	Compliance by member country
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	Tax and Company Acts stipulate form, method, and content of record-keeping. Retention for 12 years required for tax records, 7 years for accounting books and documents.
Prohibitions (UNCAC 12(3), OECD Convention 8(1)), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	1) Companies Act prohibits false entries, false statements, and manipulation of records. Penalties increase if done with intent to deceive or defraud. 2) Per Companies Act: Improper destruction or damaging of records prohibited. Penalties increase with intent to deceive. 3) and 4): No explicit prohibition, though this would be generally covered by Companies Act requirement of accurate record keeping and prohibition of falsehoods. 5) and 6): As above, no explicit bar but generally covered.

2. Financial reporting requirements

Under the Companies Act (art.56), company directors must prepare annual reports to the shareholders on the affairs of the company during the financial year. In the case of a private company, it may adopt rules requiring it to prepare an annual report when a shareholder has requested it by timely written notice. The annual report must include financial statements for the relevant accounting period, along with auditor reports in cases where audits are required. The annual report must be signed by two directors on behalf of all directors. In addition, the directors must ensure the company submits annual returns to the Registrar (art.124). Financial statements must be sent within deadlines (normally four months from balance date), and must give a true and fair view of the company's situation and be signed by two directors. Failure to comply with these requirements is subject to fines (art.130).

Financial reporting standards are set by the Samoa Institute of Accountants, which requires companies that are audited to follow either the International Financial Reporting Standards (IFRS) or other internationally accepted accounting frameworks such as US GAAP. In most cases, companies report under IFRS. In 2011, the Institute approved the use of IFRS for small and medium sized enterprises. Samoan Government-owned enterprises generally follow IFRS, and the Government Audit office expects IFRS to be used.[11]

International standard	Compliance by member country
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) Per Institute of Accountants, SOEs and other companies required to be audited must use IFRS, US GAAP or similar norms. Most companies use IFRS in practice. 2) SMEs are authorized to use IFRS for SMEs. 3) These off-balance-sheet items must be disclosed under IFRS 10.
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) IAS 37 would apply in most cases, but normally does not require disclosure of prospective corruption-related liabilities. 2) Manipulations of the kind used to conceal corruption largely prohibited (see above).

B. Audit

1. Auditing requirements

The Companies Act (arts.131-132) requires all public companies to appoint an external auditor to audit the annual financial statements. This also applies to companies whose rules require an audit in a given year, and one in which shareholders with over 20% ownership request an audit in writing. The auditor is to submit a report on the financial statements to the shareholders stating the scope and limitations of the audit, any relationship or interests of the auditor in the company, and whether the auditor received all the information and explanations she/he required. The auditor is to give an opinion on whether the company has kept proper accounting records and whether the financial statements give a true and fair view of the state of affairs and comply with regulations – or if not, in what ways they do not comply (art.138). The company directors must ensure that the auditor has access to all accounting records and other documents, and the auditor may demand any necessary information or explanations from a director or employee (art.139). Failure to comply by a director or employee with either of these requirements is subject to fines. The Samoa Institute of Accountants requires the use of International Standards on Auditing (ISA) for all company audits.[12]

The Financial Institutions Act adds certain requirements for banks and other financial institutions. The institutions must annually appoint an auditor who holds a current certificate of public practice issued under the Samoa Institute of Accountants Act 2006 and is acceptable to the Central Bank (art.10). The institution is to submit to the Bank a copy of its audited annual balance sheet and profit and loss statement with notes, and the auditor's report. In addition, the audited balance sheet and profit and loss statement are to be published in a newspaper as directed by the Central Bank, and within four months of the end of the financial year. The Bank may also require, by written notice, a report on an institution's accounting and control systems, and other matters, to be prepared by the external auditor.

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	Auditing controls are not comprehensive or detailed, and their impact on corruption is not clear.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	1) Per Companies Act: Public companies, financial institutions, SOEs, and certain others must have annual financial statements audited. Financial institutions to publish audited financial statements. 2) Private companies: no audit required in most cases.
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	Per Institute of Accountants, ISA to be used. This would include ISA 240 and 250.
Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks. 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	1) Per Companies Act: Audit report to state whether financial statements are true and fair representation of financial position, and whether accounts were properly kept. Per Financial Institutions Act: Central Bank may require an auditor report on internal controls. 2) Per Companies Act: Two company directors to sign audited financial statements. Company officers to assist auditor with information, etc. Misleading statements to auditor prohibited and penalized.

2. *Auditor reporting of improprieties*

Auditors in Samoa are subject to the duties in ISA 240 and 250 to report improprieties discovered in the course of the audit to company management. The obligation to report to external authorities depends on whether reporting such information is required and protected by law. For companies generally, there is no such legal provision. The situation is different for auditors of banks and other financial services providers. The Financial Institutions Act (art.10) requires the external auditor to report immediately to the Central Bank if information obtained in the course of the audit indicates there has been a criminal offense involving fraud or dishonesty, or serious irregularities have occurred including any that jeopardize the interests of depositors or creditors, or if the auditor has doubts about the institution's solvency. The Central Bank may require the auditor to discuss the findings and provide additional information. The auditor must take reasonable steps to inform the client in advance about an intended report to the Central Bank. No civil, criminal, or disciplinary liability attaches to the auditor as a result of the auditor's reporting the above information in good faith to the Central Bank.

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	ISA 240 and 250 advise the auditor to report irregularities to company management.
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").	1) General duties based on ISA 240 and 250 do not have the necessary legal support. But Financial Institutions Act requires bank auditors to report any serious illegalities or crimes of fraud or dishonesty to Central Bank. 2) Safe harbor provision for auditors reporting in good faith under Financial Institutions Act.

C. Professional standards and independence

The accountancy and audit market is dominated by small local firms; there are no local affiliate firms of major international accounting networks. The Samoa Institute of Accountants (SIA) accepts resident Samoans who have completed their academic training at approved universities, along with their professional training and examinations. The Institute is a member of the Confederation of Asian Pacific Accountants and in 2009 entered a Memorandum of Cooperation with Certified Practicing Accountants Australia to promote professional development and co-operation between the countries. Training and accounting practice in Samoa are influenced by New Zealand, where many Samoans live and where many professionals obtain their education and training before returning to Samoa.[13] The Institute was established under the Samoa Institute of Accountants Act,[14] which empowers it to promote the development of the profession, to conduct training and award certifications, to issue a code of ethics, and to discipline its members, who make up the accounting and audit profession in Samoa.

The Companies Act (arts.135-137) provides for the appointment of external auditors and the safeguarding of their independence. A company may only appoint as auditor a person with the professional certification to practice as an auditor. Persons who may not serve as auditors of a company include directors, officers, and employees of the company and their business partners; a corporation, liquidator, or administrator; or one who is disqualified from auditing a related company. An auditor who resigns may demand to be heard at a shareholders' meeting or have the company directors send an explanatory statement concerning the resignation to all shareholders. A company may not replace an auditor without providing opportunity for the auditor to make such representations. An auditor must ensure "that his or her judgment is not impaired by reason of any relationship with or interest in the company or any related company."

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) and 2) SIA administers standards for licensing, oversight, discipline, and ethics code.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	Per Companies Act: 1) Annual appointment and renewal of appointment. Removal requires company to permit auditor to make representations. 2) and 3): No explicit provision but general rule about impairment of judgment. 4) Restrictions on relationships with audited company, but these do not include investment. 5) No provision.
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) and 2) SIA administers licensing rules, training requirements, ethics code. Auditors study, test, and qualify abroad, most often in New Zealand. 3) SIA is a statutory body that also serves as professional membership body. 4) SIA internal committees adjudicate and impose discipline.

D. Enforcement

Samoa has stipulated penalties for the enforcement of key accounting and audit rules. These are denominated in “penalty units,” allowing for inflation-adjustment.[15] Thus, penalties provided in the Companies Act include the following:

i) Fines up to 50 units (WST 5,000 or USD 2,100):

- Failure to comply with the annual report requirements (art.56): each director is subject to the fine.
- Failure to comply with record-keeping rules (art.117): company and each director liable.
- Failure to take adequate measures to prevent and detect falsification of records (art.118): each director liable.
- Failure to keep proper accounting records (art.129): each director liable.
- Failure to provide auditor full access to records and information or to provide explanations (art.139): each director liable to fine.

ii) Fines up to 1,000 units (WST 100,000 or USD 42,400) and imprisonment for up to seven years:

- A person willfully making or authorizing a statement in an accounting document that is “false or misleading in a material particular”(including by omission) (art.340(1)).
- A company director or employee who willfully makes, authorizes, or permits a false or misleading statement concerning the affairs of the company and directed to company directors, employees, auditors, holding company officers, shareholders, creditors, trustees, receivers, or liquidators (art.340(2)).
- A director, employee, or shareholder who destroys, alters, or makes a false entry in any company register, accounting record, or other documents with intent to defraud or deceive (this includes manipulating or falsifying electronic records) (art.342).

The Financial Institutions Act (arts.16, 23) also provides penalties for false or misleading statements, attempts to obstruct an audit, and other offenses: fines up to 40 units (WST 4,000 or USD 1,700) and imprisonment for up to one year. In addition, under the Samoa Institute of Accountants Act (arts 14-15), a person practicing as an auditor without having the necessary qualifications, practice certificate, and SIA membership is subject to fines up to 100 units (WST 10,000 or USD 4,200), and an additional one unit per day (WST 100 or USD 42) for as long as the offense continues beyond the conviction.

International standard	Compliance by member country
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2): Sanctions appear adequate for this purpose, but accounting and audit rules may not be sufficient to support prevention of private sector corruption.
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Per Companies Act: Fines up to USD 2,100 for directors failing to comply with rules on annual reporting, accounting records, prevention of falsification. Deliberate falsification or improper destruction of records subject to fines up to USD 42,400 and 7 years' imprisonment. 2) Per Companies Act: Companies and directors subject to fines up to USD 2,100 for record-keeping violations. 3) Samoa is reputed to have independent courts and respect for the rule of law in most cases. Capacity for enforcement is not known.

Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Per Companies Act: Failure to cooperate with auditor subject to fines up to USD 2,100. Deliberate false/ misleading statement to auditor subject to fines up to USD 42,400 and 7 years' imprisonment. Unlicensed audit practice subject to fines up to USD 4,200 and daily fines. 2) Per Financial Institutions Act, institutions must meet audit requirements for licensing and prudential purposes. 3) Samoa is reputed to have independent courts and respect for the rule of law in most cases. Capacity for enforcement is not known.

5. Conclusion and recommendations

A. General efforts to prevent corruption involving the private sector

Samoa has ombudsman and supreme audit institutions that monitor governance in the public sector, with the former also addressing public complaints. There is no evidence of any special public-private initiatives to combat private sector corruption, nor incentives for self-reporting or integrity pacts.

Recommendations

1) Increase outreach by the Ombudsman, linking it to civic and business sector organizations to address issues of corporate governance, disclosure, and prevention of private sector corruption.
2) Explore incentives for self-reporting such as sentence mitigation, as well as private sector integrity pacts. The latter might well be worth pursuing on a regional basis among business associations in several Pacific island nations.

B. Internal controls

Samoa does not impose internal audit requirements by law, and there is no organized internal audit profession. Audit committees also are not required for private sector firms, though they are mandatory for SOEs. Internal controls are required for banks and financial services firms only, and are enforced by Central Bank supervisors.

Recommendations

1) Support the transfer of practical knowledge by international companies to Samoan businesses concerning internal audit, audit committees, and internal controls. Banks and state enterprises should be encouraged to do the same regarding their experience with audit committees and internal controls.
2) Consider phasing in internal audit, audit committee, and internal control systems as recommended or required functions in public companies. An initial phase might be to build on the information exchange suggested above to stimulate discussions and to support the drafting of a corporate governance code addressing those points.

C. Integrity of financial statements

Samoa has reasonably effective and complete provisions dealing with financial record-keeping, including the protection of accounting documents from manipulation and falsification. All companies must prepare annual financial statements. SOEs, banks, public companies, and certain others are required to report using IFRS, IFRS for SMEs, or alternatively US GAAP – and to have their annual statements audited in accordance with the ISA. Auditors are entitled to cooperation and any necessary information. The audited financials are to be signed by two directors, and in the case of banks, published. Also in the case of financial institutions, auditors are required to report fraud and other irregularities to the Central Bank, and are legally protected from liability in doing so. The accounting and audit profession is governed by the Samoa Institute of Accountants, though it appears that members are generally educated and qualified abroad. The Company Act provides safeguards for the independence of auditors, but these do not include restrictions on non-audit work, investments in the audited company, or company employment of former auditors. The financial reporting and audit requirements are enforced by means of penalties that largely appear to be proportionate, and include heavy fines and imprisonment for false statements and manipulation of records. The Central Bank enforces the equivalent rules against financial institutions.

Recommendations

1) Expand application of IFRS and IFRS for SMEs to all businesses that require audits. Consider further expansion to private companies beyond a size limit, and require CEO and CFO to sign audited financials.
2) Extend requirement and protection for auditor reporting of fraud and other irregularities beyond the financial sector to include all companies that require audits.
3) Consider enacting restrictions on auditor financial interests in audited companies, non-audit work by the auditors, and company hiring of former auditors.

Samoa Laws, Regulations, Policy Documents Referenced:

Companies Act No.6/2001,
http://sifa.ws/images/uploads/International%20Companies%20Act%201988.pdf.
Financial Institutions Act No.3/1996,
http://www.paclii.org/ws/legis/consol_act_2012/fia1996258/
Income Tax (Administration) Act No.14/1974,
http://www.paclii.org/ws/legis/consol_act_2012/ita1974268/

Samoa Institute of Accountants Act, No.7/2006, http://www.paclii.org/ws/legis/consol_act_2012/sioaa2006332/

NOTES

[1] http://www.commonwealthofnations.org/sectors-samoa/business/; http://www.commonwealthofnations.org/sectors-samoa/government/ ; http://www.dfat.gov.au/geo/samoa/samoa_brief.html ; http://www.freedomhouse.org/report/freedom-world/2013/samoa#.UzOBjvldUfU .

[2] IFC (2014), *Doing Business 2014 – Economy Profiles:* Samoa, World Bank Group, p.57; http://www.commonwealthofnations.org/sectors-samoa/business/.

[3] http://www.commonwealthofnations.org/sectors-samoa/government/ ; http://www.dfat.gov.au/geo/samoa/samoa_brief.html; http://www.freedomhouse.org/report/freedom-world/2013/samoa#.UzOBjvldUfU.

[4] http://www.ombudsman.gov.ws/

[5] There are likely to be initiatives in existence but not discussed here due to lack of information.

[6] The sources of all standards are provided in footnotes to the tables presented in the section of the Review entitled *International Standards for Country Reports.*

[7] Companies Act No.6/2001, http://sifa.ws/images/uploads/International%20Companies%20Act%201988.pdf.

[8] IMF (2010), *Samoa: Selected Issues*, IMF Country Report No. 10/215, pp. 15-16, https://www.imf.org/external/pubs/ft/scr/2010/cr10215.pdf.

[9] Financial Institutions Act No.3/1996, http://www.paclii.org/ws/legis/consol_act_2012/fia1996258/.

[10] Income Tax (Administration) Act No.14/1974, http://www.paclii.org/ws/legis/consol_act_2012/ita1974268/.

[11] http://www.commonwealthofnations.org/sectors-samoa/business/accountancy_audit_and_tax/; http://www.iasplus.com/en/jurisdictions/oceania/samoa.

[12] http://www.iasplus.com/en/jurisdictions/oceania/samoa.

[13] http://www.commonwealthofnations.org/sectors-samoa/business/accountancy_audit_and_tax/, http://www.iasplus.com/en/jurisdictions/oceania/samoa.

[14] No.7/2006, http://www.paclii.org/ws/legis/consol_act_2012/sioaa2006332/.

[15] As of 2009, one penalty unit was equal to WST 100 (currently, USD 42), per the Fines (Review and Amendment) Act 1998, http://www.paclii.org/pjdp/files/2011/07/District-Court-of-Samoa-Benchbook-2009.pdf.

Singapore

1. Introduction

Singapore is a model in several ways, including its competitive economy, high standard of living, and disciplined approach to public sector governance. Singapore's 2008 Human Development Index as measured by UNDP was the third highest in Asia after Japan and Hong Kong, China. According to the 2011 World Bank "Doing Business" report, Singapore was the best country in the world in which to run a business (for the fifth consecutive time). In the same report, Singapore trailed only New Zealand in terms of protecting investors and minority shareholders. Market competition is rigorously maintained, and the informal sector quite small. Consistent with this picture of good governance, Singapore has been quite successful in limiting corruption, having by far the lowest civil service corruption in the region. This is due to a range of factors including the priority accorded to corruption control by government, the competitive salaries paid to state officials, and the path-breaking work of the specialized Corrupt Practices Investigation Bureau (CPIB) in the prime minister's office.[1] CPIB can take action on active and passive bribery, and on bribery between private sector companies. Corporate governance codes cover businesses as well as charitable organizations.[2]

On the other hand, some features of the political and economic structure are of concern. Several publicly-listed companies are reported to have a pyramid ownership structure or cross-shareholdings that provide major shareholders a degree of control disproportionate to their beneficial ownership in the company.[3] Singapore's political reforms toward liberal democracy coexist with ruling party dominance of political life as well as significant limitations on the media, public debate, and rights of assembly – in accordance with local laws. These factors have prompted concern from foreign observers about the scope of transparency in Singapore (BTI 2012). Government points out that its approach to the media, public debate and rights of assembly is founded on the need to balance the rights of the individual against the interests of society as a whole. It is also widely acknowledged Singapore's emphasis on public order is implemented according to law.

2. General efforts to prevent corruption involving the private sector

Several government bodies conduct outreach to the private sector, often by means of training seminars and information such as guidebooks. These efforts are led by CPIB. As part of its core anti-corruption mission, CPIB receives complaints about suspected corruption from the public through a variety of means including letters, a 24-hour toll-free hotline, and an online e-

Reporting Center. Under the Prevention of Corruption Act (art.36), the identity of any such informer is protected, and sources of information not disclosed, in order to encourage people to come forward and to prevent reprisals.

CPIB also reaches out to the private sector through preventive education talks, visits, seminars, workshops, and the media to instil a culture of zero tolerance and to encourage the reporting of corrupt activities. Private entities are able to request preventive education talks through CPIB's Corporate Relations team. CPIB reports that it continuously engages the business community, including the financial sector, through seminars and assistance to companies in developing corporate anti-corruption programs. For example, CPIB has collaborated in this way with the Singapore Business Federation and the Singapore Hotel Association.

Every public agency (including regulatory authorities) reportedly has a quality service unit that deals with complaints from its customers. This provides an avenue for the private sector to report any misdeeds or infringement of regulations by public officials. If a complaint reveals any element of corruption, the public agency should refer it to the CPIB for investigation. Singapore's Civil Service hosts the Pro Enterprise Panel, bringing together members from industry and government, to receive suggestions and develop proposals for reduction of red tape in state agencies. The Panel has reviewed some 1700 suggestions since its founding in 2000, and reports having acted on over half (ADB-OECD 2009: 56).

The Accounting and Corporate Regulatory Authority (ACRA), the national regulator of business entities and public accountants in Singapore, holds programs and workshops for company directors to promote corporate governance and legal compliance. Other organizations provide such training as well, including the Singapore Institute of Directors, the Securities Investors Association (Singapore), the Singapore Exchange (SGX), and professional accountancy bodies (e.g. CPA Australia, Institute of Singapore Chartered Accountants). ACRA developed a handbook to serve as a reference and a practical guide, especially for newly -appointed directors. The Authority also took steps to enhance company compliance with statutory requirements for holding Annual General Meetings (AGM) and preparing financial statements and annual returns. These steps include a compliance rating system, the sending of reminders to the companies, and a mobile app for this purpose. ACRA also engages the business community by giving talks on raising audit quality and on good corporate governance, and issued, jointly with the Singapore Exchange and the Monetary Authority of Singapore, the *Guidebook for Audit Committees in Singapore*. [4]

International standard[5]	Compliance by member country
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	Efforts underway through several agencies including CPIB, the Civil Service, and ACRA.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) CPIB provides ample channels for complaints, and protects confidentiality. CPIB thereby aims to prompting those in the private sector who are aware of corruption cases to report without hesitation. 2) While there are no specific provisions on mitigation in the Prevention of Corruption Act, the courts have recognized that substantial cooperation in the investigation or prosecution of offences is of mitigating value.[6]
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) CPIB holds workshops at the request of companies and business associations to develop prevention programs. 2) CPIB and ACRA provide workshops, and the latter produces handbooks on aspects of compliance. 3) ACRA and other organizations such as Singapore Institute of Directors give talks to promote good corporate governance.
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	These instruments are not used to any notable extent.

3. Internal Controls, Ethics, and Compliance

A. Internal audit

Singapore's Code of Corporate Governance (CCG, Princ.13) states that each company should establish an effective internal audit function that is adequately resourced and independent of the activities it audits. Most of the listed companies assessed for the latest *ASEAN Corporate Governance Scorecard* (ADB 2013: 41-52) are reported to have disclosed the existence of a discrete internal audit function. The Singapore Exchange and the Monetary Authority of Singapore monitor compliance with the CCG by listed companies, which applies on a "comply or explain" basis. According to the Code, internal audit should be conducted according to duly adopted standards. Singapore does not impose a legal requirement or mandatory standards of internal audit *per* se, but the Code mentions the Standards for the Professional Practice of Internal Auditing set by the Institute of Internal Auditors (IIA).[7] IIA-Singapore has some 2,000 members, and the IIA standards are specifically referenced in the Code of Corporate Governance. The Singapore Accountancy Commission (SAC) is working closely with the IIA to encourage listed companies to disclose their internal audit practices.

The Code (Guidelines 13.1-13.5) does recommend the basic structures and processes for internal audit. The internal auditor's primary line of reporting should be to the audit committee chairman, and should report administratively to the CEO. The audit committee is to approve the hiring, removal, evaluation and compensation of the head of the internal audit function, or the firm to which the internal audit function is outsourced. The internal auditor should have unfettered access to all the company's documents, records, properties and personnel. The audit committee should, at least annually, review the adequacy and effectiveness of the internal audit function.

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	Internal audit recommended for all companies by Corporate Governance Code.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect "illegal acts" in the books and records of companies, including bribery and other forms of corruption.	1) The law does not specifically provide for internal audit, but the CG Code identifies IIA as source of standards. IIA-Singapore accredits and supervises internal audit professionals. 2) Internal auditor members of IIA would have this as a professional standard.
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	1) through 3) Recommended by IIA standards. 4) Per Corporate Governance Code, primary reporting is to audit committee, administrative reporting to CEO.

B. Audit committee

The Companies Act (Section 201B) requires every listed company to have an audit committee. Each audit committee should include at least three directors, the majority of whom, including the chairman, should be independent non-executive directors (and not related to any executive director). The Code of Corporate Governance (Guidelines 12.1-2) recommends that at least two members, including the chairman, should have recent and relevant financial management experience. The Guidebook for Audit Committees in Singapore, issued by ACRA, the Singapore Exchange and the Monetary Authority of Singapore, also provides practical guidance and recommendations of best practices for audit committees of companies listed on the Singapore Exchange.[8]

The Companies Act (Section 201B(5)) and the CCG (Guidelines 12.4-7) detail the functions of an audit committee. The Act requires it to nominate the external auditor and to review with the external auditor the audit plan and report, the evaluation of internal accounting controls, the assistance given by the company's officers to the auditor, the scope and results of the internal audit procedures, and the financial statements before submission to the directors. The Code recommends that the committee annually review the independence and objectivity of the external auditors, stating in the company annual report the total fees paid to external auditors with a breakdown of audit and non-audit fees. The CCG also recommends that the audit committee should review the arrangements for confidential receipt of reports concerning improprieties in financial reporting and management, with the aim of ensuring that such concerns are independently investigated and followed up. These whistle-blower protections are to be disclosed, and attested as being adequate, in the annual report. Most of the listed companies assessed for the latest *ASEAN Corporate Governance Scorecard* (ADB 2013: 41-52) report having established audit committees with the requisite independent members, and disclosing committee terms of reference and details of meetings.

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	1) Listed companies required to have audit committees per Companies Act; others encouraged to do so by CCG. 2) Companies Act requires an audit committee to include at least three directors, the majority of whom, including the chairman, should be independent. CCG recommends 2 financial experts.
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers, employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	Committee TORs: 1) Nominate external auditor, review audit plan and report, evaluate internal audit (required by the Act); review the independence and objectivity of the external auditors (recommended by CCG). 2) Evaluate internal accounting controls, assistance given by the company's officers to auditor (required by the Act). 3) No requirement. 4) and 5): CCG recommends that audit committee review arrangements for confidential receipt of reports on improprieties in financial reporting and management and follow-up.

C. Internal control and compliance systems

For companies generally, this area is covered by the recommendations in the Code of Corporate Governance. Under the Code (Guidelines 11.1-3), the board should determine a company's levels of risk tolerance and risk policies, and oversee management in the design, implementation and monitoring of the risk management and internal control systems. The board should, at least annually, review the effectiveness of these systems, including financial, operational, compliance and information technology controls. The board should comment on the effectiveness of its internal controls in the company annual report, and state whether it has received assurance from the CEO and the CFO regarding the effectiveness of these controls.

Publicly-owned and listed companies are required by law to have such systems. Under the Companies Act (Section 199(2A)), public companies must establish systems of internal accounting controls sufficient to ensure that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are properly authorized and recorded as necessary for preparation of accurate accounts. For listed companies, a statement in the annual report by the board (with audit committee concurrence) on the adequacy of company internal controls is now required under Singapore Exchange rules that took effect in 2011 (ADB 2013: 41-52; ADB-OECD 2009: 109).

In practice, internal control systems are not uniformly adopted, nor is disclosure in this area consistent. It is reported that companies generally do not disclose details of their code of ethics or the manner in which the code is implemented and compliance is monitored. Most companies do not disclose that the board of directors has conducted a review of the company’s material controls (including operational, financial, and compliance controls) and risk management systems (ADB 2013: 41-52).

International standard	Compliance by member country
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal	1) Listed companies required to disclose adequacy of internal controls per Singapore Exchange rules. Disclosure recommended for other companies by CCG. 2) Companies Act requires audit committee to evaluate internal accounting controls. 3) No requirement. 4) CCG recommends risk-based system and regular assessments of risk. No

company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees. 4) Risk-based approach: • Individualized assessment of risks to the enterprise, including corruption risks. • Regular monitoring and re-assessment of corruption risks.	explicit corruption-related risk management required.
Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements. 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations. 4) Require for third-party representatives, consultants, or agents: • Written contract, adherence to company ethics standards and anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	1) The Companies Act includes provisions that prohibit fraudulent and dishonest acts by directors and officers of companies, in particular those having an impact on financial statements (e.g. Sections 401-406), and that require internal accounting controls sufficient to ensure asset protection and proper financial reporting (section 199(2A)). 2) Private sector corruption is an offense in Singapore under the Prevention of Corruption Act (sections 5-6), which does not distinguish between public sector and private sector corruption. Again, the internal control function is not expressly given responsibility to ensure compliance with these provisions. 3) and 4): No explicit requirements.
Enforcement, including sanctions for failure to comply.	Sanctions are clearly provided for financial reporting, corruption, and other legal offenses, and for failure to establish internal control systems to ensure compliance.

4. Integrity of Financial Statements

A. Accounting

1. Financial records

The Companies Act (Section 199) requires companies to maintain accounting records for five years. The relevant terms are defined in Section 4 of the Act:

- "Accounting records": working papers and other documents necessary to explain the methods and calculations by which accounts are made up;
- "Accounts": profit and loss accounts and balance-sheets including notes attached or intended to be read them;
- "Books": accounts, deeds, writings or any other record of information, however compiled; and
- "Documents": summons, orders and other legal process, notice, register, etc.

The materials kept must be sufficient to explain the transactions and financial position of the company and enable the preparation of true and fair accounts. These records will need to be kept in a manner as to enable them to be conveniently and properly audited. If the records are kept outside Singapore, a copy will also have to be kept in Singapore.

The integrity of corporate and financial documents is protected by law. An officer of a corporation who destroys, mutilates or falsifies, or makes a false entry in a document relating to the property or affairs of the corporation (or is privy to such actions) is guilty of an offense under the Companies Act (Section 8(D)). An employee who falsifies any book, electronic record, writing or account in the possession of the employer with intent to defraud (or abets such actions) is subject to fine or imprisonment under the Penal Code (Section 477). The laws do not specifically address off-the-books, fraudulent, or deceptive accounting transactions.[9]

International standard	Compliance by member country
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	All companies to keep accounting records, as defined, for five years per Companies Act.[10]
Prohibitions (UNCAC 12(3), OECD Convention 8(1), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	1) and 2): Falsification, manipulation, improper destruction of records prohibited by Companies Act and Penal Code. 3) through 6): Accounting standards require the faithful representation and reporting of actual transactions, and fraudulent and dishonest acts are subject to sanction. All companies incorporated under the Companies Act are required to comply.

2. Financial reporting requirements

The Companies Act (Section 201) requires the directors of a company to present at the AGM a set of financial statements that are true and fair and comply with the provisions of the Act and with accounting standards. (Failure to do so is an offense subject to fines or prison, Section 204.) Companies are required to file their accounts with ACRA, and these can be viewed by the public (Section 197).[11] The company board should comment in the annual report on whether it has received assurance from the CEO and the CFO that the financial records have been properly maintained and the financial statements give a true and fair view of the company's operations and finances. The accounting standards are formulated by the Accounting Standards Council (ASC) under the Accounting Standards Act. They include the Singapore Financial Reporting Standards (SFRS)[12], which are substantially converged with the IFRS, and an alternative framework, the SFRS for Small Entities.

Singapore has adopted all the IFRS, which are mandatory for annual periods beginning on or after 1 January 2014.[13] In adopting IFRS as SFRS, the ASC has made a few modifications.[14] However, ASC announced in May 2014 that Singapore listed companies will apply a new financial reporting framework identical to the International Financial Reporting Standards (IFRS) for annual periods beginning on or after 1 January 2018. The SFRS for Small Entities is word for word the same as the IFRS for SMEs (except for references to SFRS instead of IFRS, and the inclusion of a specific additional guidance related to the accounting for agreements for the construction of real estate). In line with the Preface to the IFRS for SMEs issued by the IASB, the ASC included quantitative criteria based on revenue, assets, and employees to determine the applicability of the SFRS for Small Entities.[15]

International standard	Compliance by member country
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) through 3): All Singapore-incorporated companies must use SFRS or SFRS for Small Entities, which are largely the same as IFRS and IFRS for SMEs. This includes IFRS 10 consolidated reporting. Singapore-listed companies must comply with standards identical to IFRS beginning in 2018.
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) Disclosure of contingent liabilities and any information that is relevant to an understanding of financial statements is governed by SFRS 37 (or Section 21 of SFRS for Small Entities) and SFRS 1 (or Section 8 of SFRS for Small Entities) respectively, which are the same as the corresponding IFRS. 2) Falsification and manipulation of records are prohibited by the Companies Act and Penal Code.

B. Audit

1. Auditing requirements

Under the Companies Act (Section 195, 207), company directors are responsible for having corporate accounts externally audited and filed with the Registrar (the ACRA). All entities incorporated under the Companies Act must carry out annual external audit except dormant companies and small exempt private companies, i.e. those meeting size criteria such as a maximum of twenty shareholders and revenue of not more than SGD 5 million (USD 3.9 million). The auditor must state an opinion as to whether the accounts are in compliance with the requirements of the FRS and give a true and fair view of the company's financial position (Companies Act Section. 207).

Singapore Standards of Audit (SSA) are fully based on the International Standards of Audit (ISA) (apart from amendments to conform with Singapore law).[16] Thus, auditors should communicate deficiencies in internal controls to the companies' management and governance organs, as well as assessing and testing the risk management and internal control systems – as provided in ISA/SSA 265, 315, and 330. As for addressing fraud and non-compliance with laws and regulations, SSA 240 and 250 cover the same ground as the equivalent ISA.

There is no requirement in the Companies Act for certification of financial reports by the CEO or CFO. However, a corporate officer who gives a false or misleading statement to an auditor (or director, creditor, etc.) with intent to deceive, or permits such a statement, is guilty of an offense and subject to fines and imprisonment (Companies Act Section 402). In addition, the auditor has a right of access at all times to the accounting and other records, including registers, of the company, and is entitled to demand information from any officer of the company and any auditor of a related company (Companies Act Section 207(5)).

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	Required controls do appear largely sufficient if followed in practice.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	1) All companies must have annual independent audits per Companies Act (except as follows). 2) Small companies (up to USD 3.9 million in revenue) are exempt.
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	Singapore has adopted ISA as SSA, including ISA 240, 250, 265 and others.
Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks. 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	1) External auditor states whether accounts are fair and true according to SFRS, and provides an opinion. Assessment and testing of internal controls required by SSA 315, 330. 2) Corporate officers liable for fines and imprisonment for intentionally misleading auditor, per Companies Act. However, no requirement of certification by CEO/CFO.

2. Auditor reporting of improprieties

The auditor has a duty to report to the company's management and governance organs any defects in the accounts, whether all the required information and explanations were provided, and related matters. ISA/SSA 240 and 250 require the auditor's careful attention to possible fraud and legal non-compliance, and require these to be reported to persons charged with management and governance of the company when appropriate. The SSA/ISA themselves do not provide the legal duty or the legal permission for reporting these matters to external authorities. But the Companies Act (Section 207(9)) requires an auditor to report breaches of the Act to the Registrar, if internal reporting proves ineffective. The auditor has a further duty to report any serious offenses involving fraud or dishonesty against the company by officers or employees to the Minister of Finance (Section 207(9A)). Finally, the Act (Section 207(9B)) provides an explicit safe harbor in the latter case, stating that an auditor does not breach a legal duty by virtue of any such reports made in good faith.[17]

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	External auditor should report fraud, illegality, and internal control failures per SSA. No explicit mention of corruption, but it should be reported if it leads to material misstatements in the financial reports.
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").	1) Companies Act requires external reporting of serious offenses involving fraud or dishonesty, and in some cases breaches of the Act. 2) Companies Act provides safe harbor for reporting to the Minister of serious offenses involving fraud or other dishonesty.

C. Professional standards and independence

Auditors in Singapore are supervised by the Accounting and Corporate Regulatory Authority, the national regulator of business entities and public accountants. ACRA plays a role in the development of the public accountancy profession, while monitoring corporate compliance with disclosure requirements and regulating public accountants engaged in statutory audits. ACRA administers the Accountants Act, as well as the legislation on business formation and registration. It is a "statutory board" established under its own law, the Accounting and Corporate Regulatory Authority Act (Cap 2A).[18] ACRA also enforces the Code of Professional Conduct and Ethics, which is based on the IFAC Code of Ethics, with additional requirements for auditor independence.[19] The Code applies to public accountants and accounting entities approved under the Accountants Act. The education and qualifying requirements for public accountants, including requisite experience and annual renewal of registration, are prescribed in detail in the Accountants Act (Section 10).

ACRA houses the Public Accountants Oversight Committee (PAOC), which registers public accountants, works within ACRA to set standards and professional requirements for public accountants (including continuing education), promotes audit quality, conducts audit inspections, and deals with complaints and disciplinary procedures under the Accountants Act.[20] ACRA monitors the quality of audits performed by public accountants through its Practice Monitoring Program (PMP) (i.e. audit inspections) and Firm Reviews. If a public accountant (PA) has failed to comply with regulatory and practice standards, ACRA has several recourses, from ordering remedial action (e.g. peer reviews of the PA's assignments) to restricting the PA's practice or cancelling the professional registration. PMP issues annual public reports on the overall quality and direction of auditing practice in Singapore.

The Code of Corporate Governance (Princ.12) provides standards for safeguarding the independence and objectivity of the external auditor, and these are developed in more detail in the Guidebook for Audit Committees in Singapore issued by ACRA. Thus, for example, the CCG (Guideline 12.6) recommends that a company's audit committee review the external audit, as well as the independence and objectivity of the external auditors. The committee should monitor the effects of any non-audit work by the external auditor on the latter's objectivity, and disclose in the company annual report the total fees paid to external auditor with a breakdown of audit and non-audit fees. The CCG (Guideline 12.9) would bar from a company's audit committee anyone who served as external auditor within a year, and anyone with a financial interest in the audit firm. While this provision does not rule out other possible employment in the audited company, the guidelines in the Code of Professional Conduct and Ethics for Professional Accountants and Accounting Entities may be interpreted as requiring such a bar in certain cases.[21] The Guidebook (sec.V) advises that no external auditor should be retained who has any business interest in the company. It also recommends limiting audit partner engagements to a maximum of period of years, such as the five-year rotation of audit engagement partners required for issuers listed on the Singapore Exchange. In addition, audit firms are subject to national standards based on International Standards of Quality Control, covering internal governance and quality control.

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) ACRA applies the Accountants Act and rules, as well as Professional Code, dealing with qualifications, licensing, inspection, and discipline of public accountants (practitioners). The Institute of Chartered Accountants (ISCA) administers the Singapore Qualification Programme (SQP) for accountants, including non-practitioners. 2) Professional Code is based on IFAC Code.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	1) Appointments covered by CCG and Guidebook on Audit Committees. Companies Act section 10 and Code of Professional Conduct and Ethics provide independence requirements. 2) Audit committee must monitor and disclose auditor's non-audit work and breakdown of fees for audit and non-audit work. 3) Partner rotation every 5 years per Exchange rules and Guidebook. 4) and 5): Restricted by CCG and Guidebook
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) and 2): Provisions of Accountants Act and Professional Code administered by ACRA (and ISCA for non-public accountant ISCA members). 3) PAOC, under ACRA, enforces auditing standards and Ethics Code. 4) ACRA, along with ISCA, administers disciplinary rules.

D. Enforcement

In terms of bookkeeping and financial reporting, a range of sanctions is available under the Penal Code and the Companies Act. An employee who falsifies accounts or records of the enterprise with intent to defraud (or abets such actions) is subject to fines and to imprisonment for up to ten years (Penal Code Section 477). In the course of any investigation under the Companies Act, if proper books of account were not kept by the company for two years immediately preceding the investigation or winding up of the company, every corporate officer who is in default is subject to a fine of up to SGD 5,000 (USD 3,900) or up to one year's imprisonment (Companies Act Section 339). Officers include directors, secretaries, executives, and liquidators. Some sector-specific laws contain more stringent penalties. For example, the Banking Act (art.67) provides for up to SGD 125,000 (USD 98,000) in fines and three years' imprisonment for any director, officer, employee, auditor, or agent of a bank who wilfully falsifies (including by omission), alters, or destroys financial or business documents including books, records, reports, accounts, and backup materials.

Directors of a company failing to comply with the prescribed accounting standards are subject to fines up to SGD 50,000 (USD 39,000). If fair and true accounts compliant with SFRS are not presented to the shareholders as required, company directors are liable to imprisonment for up to two years (Companies Act Section 201, 204). Insolvency or damage to shareholders is not a prerequisite for these penalties, but it is a defense that an omission was unintentional and immaterial. ACRA has direct oversight over the Companies Act and can penalize offenders, but matters of fraud must be handled by law enforcement authorities (e.g. Commercial Affairs Department). In the two-year period from 2010 to 2012, government reports 11 cases concluded, all against individuals, in the form of advisory or warning letters.

ACRA and others exercise the same authority in the case of audit violations. A corporate officer who gives a false or misleading statement to an auditor (or director, creditor, etc.) with intent to deceive, or permits such a statement, is liable to fines of up to SGD 10,000 (USD 7,800) and imprisonment for up to two years (Companies Act Section 402). Fines of up to SGD 100,000 (USD 78,000) can be levied against firms. A company's failure to appoint an auditor in a timely way makes its directors liable to fines up to SGD 5,000 (USD 3,900) (Companies Act Section 205(17)). ACRA, in exercising its oversight of auditors and of audit quality under the Accountants Act, has authority to sanction auditors and audit firms. In the two years spanning 2010 to 2012, ACRA inspected 323 public accountants and imposed 11 suspensions or cancellations.

The individual sanctions discussed here apply to company directors and other officers, as well as to auditors and audit firms. While prison terms are provided, most fines appear to be fairly low in light of salary levels in Singapore.

International standard	Compliance by member country
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) Accounting standards and sanctions appear stringent, but until recently did not appear to be rigorously enforced. Government reports that ACRA has recently introduced changes to strengthen the financial reporting surveillance regime by cyclically reviewing the financial statements of all listed companies and selected unlisted companies with public interest concerns. 2) Audit standards are reasonably strict. Sanctions are less so but appear to be seriously enforced.
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Sanctions range up to fines of USD 98,000 and ten years' imprisonment for the worst offenses. 2) Penalties apply to directors, officers, accountants, auditors, audit firms, and in some cases the companies issuing the financial statements. 3) Government has provided enforcement data, which do not evidence rigorous prosecution.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Sanctions range up to fines of SGD 10,000 (USD 7,800) for individuals and SGD 100,000 (USD 78,000) for firms, and imprisonment for 2 years,[22] as well as auditor license suspension or cancellation. 2) Penalties apply to directors, officers, accountants, auditors, audit firms, and in some cases the audited companies. 3) Government has made enforcement data available suggesting moderately stringent enforcement against auditors.

5. Conclusion and Recommendations

A. General efforts to prevent corruption involving the private sector

Singapore's government has a number of outreach efforts ongoing on prevention of corruption and on broader themes of good government and the investment climate. The leading agency here is CPIB, which engages in a range of outreach activities and seminars, and provides channels for confidential reporting of corruption offenses. Government reports that sentence mitigation is available for individuals and firms that self-report. There is currently no provision for sentence mitigation for individuals and firms that take preventive action, nor provision to cater for the use of private sector integrity pacts (i.e. agreements in which companies pledge to abide by anti-corruption rules and then monitor each other).

Recommendations

1) Consider incorporating into the Prevention of Corruption Act and Penal Code provisions on sentence mitigation for self-reporting and prevention. Mitigation is reported to be a recognized practice under common law. Formally incorporating provisions on mitigation for cooperation, and especially for preventive measures, could clarify and strengthen incentives for companies to act appropriately.
2) Consider supporting the use of integrity pacts in areas of the private sector that are vulnerable to corruption, and where such pacts might have an impact.

B. Internal Controls, Ethics, and Compliance

In this area, the standards of good practice are well articulated (even though not all are required by law or practiced by the majority of companies). Internal audit is recommended by the CCG, which is in effect a regulatory standard for listed companies. The Companies Act (Section 199(2A)) requires public companies and their subsidiaries to maintain effective internal controls.[23] The professionals who conduct internal audits are not regulated by national laws but are governed by IIA standards – and companies are accordingly monitored by regulators on their internal audit practices. Audit committees are required for listed companies and internal controls for all public companies. The internal control norms do not specify means of ensuring companies' commitment to a code of conduct and risk management, nor do the standards deal explicitly with corruption. Compliance with internal control requirements, and disclosure of such controls, is not uniform.

Recommendations

1) Incorporate explicit corruption-prevention provisions into rules on internal audit, audit committee, and internal control and risk management systems.[24]
2) Monitor and enforce internal control requirements more rigorously. This could be done by adopting sanctions across the board for failure to comply, and using external audit data on internal controls from PAOC monitoring as performance indicators.[25]

C. Integrity of Financial Statements

Singapore has relatively robust rules and enforcement mechanisms here. However, there are a few gaps to fill in order to bring the systems relating to financial reporting into line with international norms on prevention of private sector corruption. In terms of accounting and record-keeping, there are no specific prohibitions on off-the-books transactions that are potentially deceptive, nor on other account manipulations aimed at disguising fraud and corruption. The limits to disclosure and reporting of corrupt transactions under the SFRS, mirroring those in the IFRS, appear to discourage stronger action to deter private sector corruption. Importantly, the Companies Act requires external auditors to report serious offenses involving fraud or dishonesty, and provides a “safe harbor” to protect the auditor from liability. Financial statements are not required to be signed or certified by company CEOs or CFOs, a requirement that would help to reinforce liability for misstatements. Prohibitions on auditor conflicts of interest could be strengthened.

Recommendations

1) Consider increasing the record retention period from five to at least seven, if not ten, years. If the shorter period is retained, it should be clearly justified by considerations of consistency and proportionality.[26]
2) Consider enacting specific prohibitions on off-the-books transactions and other potentially deceptive accounting practices that may be used to disguise corruption. If existing safeguards are deemed to cover all of these practices by implication, it would still be useful to provide explicit guidance or notice about these specific methods.

3) Adopt explicit rules restricting hiring by companies of former auditors. As above, if existing safeguards are deemed to cover such practices by implication, it would still be useful to provide explicit guidance or notice here.
4) Increase fines for individuals and companies in the Companies Act and Penal Code provisions on financial reporting offenses.[27]

Singapore Laws, Regulations, Policy Documents Referenced:

Accountants Act (Cap 2)[28]
Accounting and Corporate Regulatory Authority Act (Cap 2A)
Accounting Standards Act
Audit Committee Guidance Committee, *Guidebook for Audit Committees in Singapore*, ACRA, http://www.acra.gov.sg/Publications/Guidebook+for+Audit+Committees+in+Singapore.htm
Code of Corporate Governance, 2012, http://rulebook.sgx.com/en/display/display_main.html?rbid=3271&element_id=5885
Code of Professional Conduct and Ethics, ISCA, http://ethics.isca.org.sg/ecode
Companies Act No.42/1967 (cap.50) as revised Penal Code
Prevention of Corruption Act
Singapore Financial Reporting Standards, http://www.asc.gov.sg/frs/index.htm
Singapore Standards on Auditing, http://caa.isca.org.sg/standards/ssa.

NOTES

1 BTI (2012), Singapore Country Report, Bertelsmann Stiftung, http://www.bti-project.org/countryreports/aso/sgp/.
2 ADB and OECD (2009), *Strategies for Business, Government and Civil Society to Fight Corruption in Asia and the Pacific: Proceedings of the 6th Regional Anti-Corruption Conference*, p. 54, 175.
3 ADB (2013), *ASEAN Corporate Governance Scorecard: Country Reports and Assessments 2012–2013*, p.41-52
4 http://www.acra.gov.sg/Publications/Guidebook+for+Audit+Committees+in+Singapore.htm.
5 The sources of all standards are provided in footnotes to the tables presented in the section of the Review entitled *International Standards for Country Reports.*
6 Section 35(3) of the Prevention of Corruption Act provides that a court may grant a certificate of indemnity to a person (including a co-accused person) if it is of the

opinion that this person has made true and full discovery of all things he was examined on, and this certificate is a bar to all legal proceedings against the person in respect of those things.

[7] Although maintaining an internal audit function is not expressly required by the Companies Act, Section 199(2A) of the Act requires every public company and every subsidiary of a public company to maintain a system of internal controls sufficient to provide reasonable assurance that (a) assets are safeguarded against loss from unauthorized use or disposition; and (b) transactions are properly authorized and recorded as necessary to permit the preparation of true and fair profit and loss accounts and balance-sheets and to maintain accountability of assets.

[8] http://www.acra.gov.sg/NR/rdonlyres/49C641A3-1FF4-4E2D-99FC-71AC04E2C750/9909/Finalinsidetext241008cast.pdf.

[9] The government states that sufficient safeguards are in place to lower the risk of deceptive accounting practices. This is based on the fact that accounting standards require the faithful representation and reporting of actual transactions, that fraudulent and dishonest acts are subject to sanction, and that all companies incorporated under the Companies Act are required to comply.

[10] As compared to seven-year retention rule in US Sarbanes-Oxley Act (sec. 210.2-06) (see international standards matrices).

[11] ADB-OECD report PS 2009: 109.

[12] http://www.asc.gov.sg/frs/frsEffective01012013.htm.

[13] Government notes that there is one exception –IFRIC 2, *Members' Shares in Co-operative Entities and Similar Instruments*.

[14] Specifically (i) exemptions from presenting consolidated financial statements and applying the equity method to investments in associates and joint ventures, (ii) additional guidance related to the accounting for agreements for the construction of real estate and (ii) different effective dates and transition provisions.

[15] An entity is eligible to use the SFRS for Small Entities if it is not publicly accountable, publishes general purpose financial statements for external users, and meets the definition of a "small entity" for each of the previous two consecutive financial reporting periods, i.e. it meets at least two of the three following criteria: total annual revenue of not more than SGD 10 million (USD 8 million), total gross assets of not more than SGD 10 million, total number of employees of not more than 50. Companies are allowed to use IFRSs as issued by the IASB (rather than SFRS) on approval by ACRA. Other deviations from SFRS or SFRS for Small Entities are permitted in special circumstances, such as a statement by the external auditor that this is necessary for accurate reporting (Companies Act art.201).

[16] http://caa.isca.org.sg/standards/ssa

[17] The issue of the auditor's liability does not appear to arise with regard to reporting breaches of the Act to the Registrar, since financial reporting is public and the reporting of breaches is in the first instance the duty of the company.

[18] http://www.acra.gov.sg/.

[19] http://ethics.isca.org.sg/ecode

[20] http://www.acra.gov.sg/About_ACRA/Public+Accountants+Oversight+Committee.htm.

[21] As the government notes, the Code provides that all self-interest, familiarity and intimidation arising from employment in the audited company should be evaluated, and safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include policies and procedures to

require the individual to notify the firm when entering serious employment negotiations with the assurance client, removal of the individual from the assurance engagement, and performing an independent review of any significant judgments made by that individual while on the engagement.

[22] The Accountants Act has imprisonment provisions only for fraudulent registration and for"'holding out" as a public accountant when not registered – as noted by government.

[23] Section 199(6) of the Companies Act makes clear that default in compliance renders "the company and every officer of the company who is in default" liable to fine of up to SGD 2,000 and/or imprisonment for a term of up to 3 months, as well as to a default penalty. Officer in default includes director, company secretary, CEO, etc.

[24] Government points out that corruption-prevention provisions are embedded in the IIA standards and the Code of Corporate Governance. The suggestion here, however, is that there need to be more specific and explicit provisions for preventing practices linked to corruption, especially the bribery of foreign officials.

[25] Government notes that the Code of Corporate Governance and SGX listing rule 1207(10) contain provisions on internal controls. For example, the Code states that the audit committee should review the adequacy of the company's internal controls, and the SGX Listing Rule states that the Board should ensure that a sound system of risk management and internal controls exists to safeguard shareholders' interests and the company's assets.

[26] As the government notes, Singapore reduced the record retention period from 7 years to 5 years in 2007 as part of broad set of Companies Act amendments in line with the Government's decision to reduce record-keeping periods in a number of statutes in order to alleviate the burden on businesses.

[27] The government points out that it recently introduced changes to strengthen its financial reporting surveillance program, such as extending the coverage of surveillance to financial statements with clean audit reports (in addition to those with modified audit reports) and to certain non-listed companies, as well as collaborating with professional bodies (i.e. Institute of Chartered Accountants) to increase the breadth and depth of the financial reporting surveillance regime.

[28] Singapore legislation to be found at http://statutes.agc.gov.sg/aol/home.w3p.

Solomon Islands

1. Introduction

The Solomon Islands, an archipelago of over 900 islands, has a predominantly Melanesian population of some 555,000 and a per capita GDP of about USD 1,100. The economy is largely based on agriculture, fishing, and forestry, but the services sector now accounts for over 60% of the nation's GDP. Growth exceeded 6% for 2006-10 despite a major downturn in 2009, reaching nearly 11% in 2011 and about 5% in 2012 – helped by steady high revenue from logging and mining. The minerals sector in the Solomons has experienced turbulence in recent years, as all production ceased in 2000 due to civil strife and land ownership disputes, and the economy collapsed. Mining is a growth sector, and gold in particular has been a critical source of export revenue, its importance rising as logging exports are set to decline as factor in the economy. The Gold Ridge gold mine near the capital of Honiara restarted production in 2011. Despite progress in recent years, the Solomon Islands remains a complex country in which to do business. Costs are often high, regulatory processes slow and complicated and essential services unreliable and expensive. Exports from Solomon Islands also face high transport costs to reach the main global markets.[1]

Since independence in 1978, the Solomon Islands has been a member of the Commonwealth, governed by a unicameral national parliament. Party structures are fluid, with extensive coalition-building usually required to form a government. A major player in the country's governance over the past decade has been the Regional Assistance Mission to the Solomon Islands (RAMSI). In the wake of four years of civil conflict, government leaders in 2003 negotiated with Australia and New Zealand a comprehensive package of strengthened assistance, which was then endorsed by a meeting of the Foreign Ministers of the Pacific Islands Forum. RAMSI is a long-term commitment aimed at helping create the conditions necessary for a return to stability, peace and a growing economy. The joint Partnership Framework of 2009 sets out shared objectives and timelines for RAMSI's work, so that RAMSI activities can gradually draw down as the Solomon Islands' capacity grows.[2] The most recent national elections were held peacefully in August 2010, with several parties joining to form a government under the National Coalition for Reform and Advancement.[3]

Combating corruption became a priority when, in ten special audits conducted into government departments and agencies following RAMSI's arrival, it was found that SBD 433 million (USD 59 million[4]) had been lost or foregone through corruption or maladministration. In 2009, the Partnership Framework identified anti-corruption as one of the key issues that cut across all areas of the partnership's activities, and committed the Government and RAMSI to mainstream anti-corruption efforts across Solomon Islands Government and

RAMSI programs. The framework outlines a range of targets, including the development of a formal Anti-Corruption Policy, the establishment of an Anti-Corruption Taskforce, and the establishment of an effective anti-corruption agency. The Solomon Islands adopted legislation to reform the role of political parties, aiming to reduce corrupt incentives and enhance political stability.[5] The Cabinet has commissioned the drafting of a strategy to implement the relevant provisions of United Nations Convention against Corruption.[6]

2. General efforts to prevent corruption involving the private sector

Improving the business environment is one of the priorities of the RAMSI Partnership. The Solomon Islands Ministry of Finance and Treasury is working with RAMSI advisors to remove many of the procedures that have become roadblocks to economic growth in Solomon Islands. This work has led to the adoption of new legislation making it easier to start a business, a reduction in costs and processing time for those seeking to register businesses, and a rise in the number of new companies registered in Solomon Islands. The joint efforts also helped produce new legislation on foreign investment, companies, and customs.[7] The Solomons also has an Ombudsman Office, which deals with administrative problems of individuals and businesses. The Ombudsman has introduced an innovative "aerogram" initiative for members of the public to report maladministration by Government officials. Through an agreement with Solomon Islands Post, pre-paid complaints aerogrammes are now available at post offices throughout Solomon Islands to help members of the public easily report poor administration.[8]

The government is developing its national Anti-Corruption Policy, an effort that has at times involved nationwide workshops funded by RAMSI. The Anti-Corruption Taskforce[9] envisioned in the Partnership Framework operates under the Prime Minister, and is co-chaired by the Special Secretary to the Prime Minister and the Auditor-General. It includes senior representatives from agencies such as the Law Reform Commission, the Ombudsman's Office, the Leadership Code Commission, and the Ministry of Finance, and includes members from two non-government organizations: The Chamber of Commerce and Industry and Transparency Solomon Islands.[10]

In 2011 the Solomon Islands Government agreed to implement the Extractive Industries Transparency Initiative (EITI), and proceeded to establish a National Stakeholder Group for this purpose, comprised of extractive companies, government and civil society (including land owner groups). The group is the primary body responsible for coordinating and overseeing implementation of the global EITI standards in the Solomon Islands. The body will establish a framework to promote collaboration and consensus building, and produce the work plan. It has produced the initial EITI report, covering financial years 2012-2013. The reports are intended to disclose the payments and revenues from Gold Ridge, the only producing gold mine in the country, as well as payments and revenues from the four largest prospecting companies.[11]

International standard[12]	Compliance by member country
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	Efforts underway by a task force including government, public agencies, civic and business associations.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) Ombudsman provides channel for complaints by individuals and businesses. An ICAC is planned but not yet established. 2) There does not appear to be provision for sentence-mitigation in return for self-reporting or preventive steps.
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) The Anti-Corruption Taskforce and the EITI Stakeholder Group are coordinating state-private efforts on corruption and mining transparency. 2) and 3): Taskforce and EITI Group generally address these points, but no other known initiatives.
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	EITI uses domestic and international peer pressure to ensure transparency in mining revenues. No other known initiatives of this kind.

3. Internal controls

A. Internal audit

The Solomon Islands imposes no legal requirements with respect to internal controls, whether internal audit, audit committees, or internal control and compliance systems. As for internal audit, this is no doubt practiced, above all by the international banks operating in the country. But there is no legal-regulatory requirement.

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	No requirement.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect "illegal acts" in the books and records of companies, including bribery and other forms of corruption.	1) and 2): No organized profession or standards in SI.
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	1) through 4): No provision.

B. Audit committee

Audit committees or similar bodies are not required by the laws of the Solomon Islands. The Companies Act,[13] however, empowers the directors of public limited companies to establish committees to carry out this and other responsibilities, and provides basic rules of operation (First Schedule, Part I, arts.102-105).

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	1) Companies Act enables PLC directors to delegate responsibilities to duly established committees. 2) No requirement.
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers, employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	1) through 5): No provision.

C. Internal control and compliance systems

Again, there are no legal requirements here. Although control systems as such are not stipulated, the Companies Act (sections 182, 187-191) does impose standards for the avoidance or disclosure of conflicts of interest and related-party transactions. Thus, public companies may not lend to their directors or the directors of a holding company (with limited exceptions). The companies must keep a register of share and debenture holdings by directors, and report in the annual accounts any loans to company officers (with limited exceptions). Directors are required to give notice to the company of any such loans, shareholdings, or interests in company transactions. Failure to do so is subject to modest fines.

International standard	Compliance by member country
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees. 4) Risk-based approach: • Individualized assessment of risks to the enterprise, including corruption risks. • Regular monitoring and re-assessment of corruption risks.	1) through 4): No requirement.
Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements. 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations. 4) Require for third-party representatives, consultants, or agents: • Written contract, adherence to company ethics standards and	1) Restrictions on loans to directors, reporting requirements for loans to officers and director interests. 2) through 4): No provision.

anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	
Enforcement, including sanctions for failure to comply.	Small fines for failure to report interests.

4. Integrity of financial statements

A. Accounting

1. Financial records

The Companies Act (sec.141) requires proper books of account to be kept covering all sums received and spent, sales and purchases, and assets and liabilities of the company. The books must be sufficient to give a true and fair view of the state of the company's affairs and to explain its transactions. Where the books are kept abroad, sufficient accounts and returns are to be kept in the country to disclose with reasonable accuracy the financial position of the business at intervals of six months, and to enable the preparation of proper financial reports. Directors failing to take all reasonable steps to comply are subject to small fines as well as imprisonment if the offense is willful. No retention period is stated.

International standard	Compliance by member country
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	Companies to keep proper records. No retention period stated.
Prohibitions (UNCAC 12(3), OECD Convention 8(1)), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	1) through 6): Records must provide a “true and fair” view of company affairs. No other provision.

2. Financial reporting requirements

The Companies Act (secs.142-143, 146) provides that the directors of every company are responsible for producing annual financial statements (balance sheet and profit and loss or income and expenditure account) and presenting them to the shareholders at the AGM. The statements are to give a true and fair view of the state of the company’s affairs – except that consolidated statements must do so for the company and subsidiaries as a group. A report by the directors on the state of the company’s affairs must be attached to the financial statements (sec.151). Directors failing to take all reasonable steps to comply with the above requirements are subject to modest fines as well as imprisonment if the offense is willful.

Private companies are not held to requirements as strict as those applicable to public companies. The Act (secs.118-123) provides that companies are to submit annual returns to the Registrar, attaching copies of the annual financial statements, directors’ reports, and auditors’ reports – certified by a director and the company secretary. Private companies are exempt from the requirement to attach financial statements and directors’ and auditors’ reports to the annual return. They are instead to submit a certificate signed by a director and the secretary affirming their continued status as private companies. The Act defines a company as private (sec.29) when its charter restricts the right to transfer shares, prohibits any invitation to the public to subscribe for any shares or debentures of the company, and limits the number of members to 50 (not including employees and certain former employees).

Foreign companies must prepare company or group financial statements as if they were domestic Solomon Islands companies, and submit them to the Companies Registrar (sec.348). Financial institutions are to prepare annual financial statements and group statements in the same way (with foreign banks to report on their business in the Solomons only), and to submit them to the Central Bank, according to the Banking Act[14] (sec.16). A financial institution must submit its audited balance sheet to the Central Bank, publish it in the official gazette, and display in a conspicuous place in each office and branch (sec.17). An institution failing to comply is subject to fines.

The Solomon Islands until recently had no national accounting standards. The Auditor General several years ago undertook to adopt IFRS for the government's accounts, and the Central Bank also adopted and began to apply IFRS.[15] The Solomon Islands began the process of formally adopting national accounting standards in 2010, when the Accountants Act was passed. The IMF is assisting the government in its adoption of the IFRS, and the Central Bank complies fully with IFRS. In 2012, it was reported that no companies complied with IFRS, while a more recent report states that companies in the Solomon Islands are required to apply IFRS.[16] Thus, it appears that the public sector is implementing IFRS, and that the process is underway to apply IFRS in the private sector – a process that is not yet complete.

International standard	Compliance by member country
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) Companies are required to produce annual financial statements. IFRS have been adopted but apply only to certain state institutions including the Central Bank. Public companies will likely be the first to apply IFRS. 2) Private companies not required to submit audited financial statements for review or to apply IFRS. 3) Companies Act requires group statements for companies and subsidiaries.
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) IFRS address contingent liabilities in IAS 37, which normally would not require disclosure of prospective liability for corruption offenses. IFRS in the process of being adopted for the private sector. 2) Financial records should include all relevant transaction and asset-liability information, and be "true and fair," per Companies Act.

B. Audit

1. Auditing requirements

The Companies Act requires companies to have their annual financial statements audited, but it exempts private companies from certain of the audit-related requirements. As stated above, companies are to submit annual returns to the Registrar, attaching certified copies of the annual financial statements, directors' reports, and auditors' reports – but private companies are exempt. Thus, while all companies in principle are required to be audited, only public companies' audited financials are reviewed by the Registrar. The Act provides that companies are to appoint auditors annually at the AGM (sec.153). The company balance sheets are to be signed by two directors (for banks, three directors and a secretary or manager), and the profit and loss statement and consolidated group accounts are to be approved by the board and attached. These financial statements, with the auditor's report, are to be sent to every member, shareholder, and holder of debentures (secs.149-152). Failure to have the statements properly signed, accompanied by the auditor's report, or circulated is an offense by the company and every officer in default and subject to a small fine.

The auditors must prepare a report on the company accounts (sec.156, 9th Sched.). The report must expressly state whether the auditor obtained all the information and explanations required, whether proper books of account have been kept by the company (and proper returns received from branches not visited by them), whether the company's financial statements are in agreement with the books of account and returns, and whether the accounts provide a true and fair view of the company's affairs and status (with equivalent statements for consolidated accounts). The auditor has a right of access to the books of account and other documents of the company, and may require from company officers any information or explanations needed for the audit – and is entitled to attend any general meetings.

The Banking Act (sec.19) adds that every licensed financial institution must have its accounts audited by a professional approved by the Central Bank and must submit the auditor's report to the Central Bank. Failure to do so is subject to fines levied on the institution. A Central Bank regulation[17] further requires that the auditor must submit to it an opinion on several issues including whether prudential guidelines are being met, and whether, for foreign bank branches, transactions between the foreign bank branch and the head office or any affiliate are properly supported, not preferential, and consistent with similar transactions by the branch with other third parties. Also, the financial institution must have the auditor review its risk management systems and report on this to the Central Bank. Failure to comply may result in the CBSI's finding of unsound and unsafe practices, and its taking corrective action such as a cease-and-desist order or changes to the institution's management.

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	Not clear whether controls are sufficient for this purpose.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	1) Companies Act requires companies to have accounts audited. Banking Act requires financial institutions to have auditors approved by Central Bank, and to publish and post audited financials. 2) Private companies exempt from submitting audited financials to Registrar, per Companies Act.
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	Unclear what audit standards are used in SI.
Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks. 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	1) Per Companies Act: Auditor to state whether financial statements provide a true and fair view, and whether proper accounts have been kept and statements agree with documentation. Per Banking Act: Auditor to report to Central Bank on institution's risk management. 2) Per Companies Act: Company to have financial statements signed by directors. Per Banking Act: statements to be signed by directors and manager or secretary. Auditors have right to require information and explanations, and to attend meetings.

2. *Auditor reporting of improprieties*

There appears to be no legal provision for reporting of improprieties by any auditor. Rather, the Companies Act and Banking Act provide for investigations of company affairs. The Companies Act (secs. 158-162) allows for investigations upon application by the shareholders or on the initiative of the competent Minister. The shareholder vote must be by a minimum number (200 for share companies, otherwise one-fifth of members) and backed by evidence, while the Minister's initiative must be based on indications that the company is conducting its business with the intent to defraud, and similar reasons. Company officers and agents must provide any documents required by the inspector, or face liability for contempt of court. The inspector reports to the Minister. Similarly, under the Banking Act (sec.20), the competent Minister may appoint an inspector based on indications from the Central Bank that a financial institution is not complying with the Act or not conducting business in a sound manner. The Minister has access to the range of corrective action available to the Central Bank to ensure that any issues are resolved.

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	This is required by ISA 240 and 250, to the extent these are applied in SI.
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").	1. No requirement, but provisions in the Companies and Banking Acts enable the appointment of government inspectors to investigate possible fraud, legal non-compliance, or unsound practice. 2. No provision.

1) Professional standards and independence

The accountancy sector in the Solomon Islands is small and at an early stage of development. The Institute of Solomon Islands Accountants seeks to regulate and improve the practice of accountancy in the country and is a member of the Confederation of Asian and Pacific Accountants. Professional accountants and auditors to date have qualified abroad, since there have been no recognized training programs in the Solomons. It is possible, for example, to follow Association of Chartered Certified Accountants courses online and to take qualifying exams in Australia or New Zealand.[18] The Accountants Act,[19] adopted in 2010, establishes the Institute of Solomon Islands Accountants (secs.9-12) as a membership-based governing body to regulate the profession. The Institute is authorized to apply the required qualifications and standards, provide training, conduct quality control, and impose discipline. At the same time, the Institute is to develop the profession and represent its interests. The Registration Committee is to be established by the Institute to enroll the different kinds of professionals in the field, e.g. CPAs, auditors, liquidators, book-keepers. Unauthorized practice, false statements in registration documents, and other offenses are subject to sanction (secs.21-39). A Disciplinary Board is also established to enforce the rules, with sanctions including warnings, suspension or removal, and fines denominated in penalty units (secs.40-51).

The Companies Act (secs.153-155) provides for the appointment of auditors and safeguards of auditor independence. Auditors are appointed at the AGM for one year and automatically re-appointed unless disqualified, replaced by AGM resolution, or unwilling to be re-appointed (having given written notice to that effect). A resolution to replace the auditor requires special notice. An auditor who is being replaced has the right to make representations and have them presented to the members/shareholders. Company auditors are required to be members of the Institute of Solomon Islands Accountants and qualified to practice in an accepted Commonwealth jurisdiction. Or, they must be recognized by the competent Minister as having equivalent qualifications, and certified by the Institute as qualified to practice in the Solomons. A company auditor may not be an officer or employee of the company or the business partner or employee of such person, or a corporation. Also, an auditor may not be a person disqualified from serving as auditor of the company’s subsidiary or holding company. Certain of the above provisions do not apply in the case of private companies.

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) Per Accountants Act, standards to be set by Institute as authorized by the competent Minister, and applied by the Institute. 2) Standards to include ethics code. No further detail.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	1) Auditors to be appointed by AGM resolution and automatically re-appointed unless replaced by AGM resolution – with right to make representations. 2) and 3): No provision. 4) Auditor relationships to audited company are limited, but not financial interests. 5) No restriction.
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) Auditors must be registered members of Institute and accepted as qualified by Minister. 2) Institute to set training requirements. 3) and 4): Institute, a membership-based professional body, supervises audit quality and imposes discipline including suspensions, fines, etc.

C. Enforcement

The Companies, Banking, and Accounting Acts provide sanctions for violations. The Accounting Act sanctions are described above. The Companies Act imposes a fine of SBD 200 (USD 27) and imprisonment for one year on any director of a company failing to take all reasonable steps to ensure the company's compliance with financial record-keeping and financial reporting requirements (secs.141-143), but in most cases imprisonment is reserved for willful violations. If a balance sheet is circulated without the necessary signature or attachments, the company and every officer in default is subject to a fine of SBD 100 (USD 14) (sec.149). A company acting as auditor of another company is liable to a fine of SBD 200 (USD 27) (sec.155). Anyone willfully making a statement that is false in any material particular in a report, return, balance sheet, or other document is liable to a fine of SBD 200 (USD 27) and imprisonment for two years (sec.371). The Banking Act (secs.17, 19) applies a fine of SBD 1,000 (USD 136) to institutions failing to publish or display their audited financials, and a fine of SBD 2,000 (USD 271) to institutions failing to have financial statements audited or to submit them to the Central Bank. The above sanctions provisions are illustrative.

International standard	Compliance by member country
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2): Accounting and audit rules are relatively new, and the record of enforcement not well developed as yet.
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Sanctions include very light fines, but also imprisonment for up to two years and suspension from accountancy practice. 2) Certain penalties apply to companies, per Companies and Banking Acts. 3) Effectiveness of enforcement is uncertain.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Sanctions include very light fines, but also imprisonment for up to two years and suspension from auditing practice. 2) Certain penalties apply to companies, per Companies and Banking Acts. 3) Effectiveness of enforcement is uncertain.

5. Conclusion and recommendations

A. General efforts to prevent corruption involving the private sector

The Solomon Islands has some anti-corruption coordinating efforts underway, led by representatives of government, public agencies, civic and business associations. The Ombudsman provides a channel for complaints by individuals and businesses. An ICAC is planned but not yet established. There does not appear to be provision for sentence-mitigation in return for self-reporting or preventive steps. The Anti-Corruption Taskforce and the EITI Stakeholder Group are coordinating state-private efforts on corruption and mining transparency, touching on private sector ethics and governance. The EITI uses domestic and international peer pressure to ensure transparency in mining revenues. No other transparency pacts are in evidence.

Recommendations

1) Move ahead with plans to establish ICAC. Build in incentives to be made available to companies, such as sentence-mitigation, in return for self-report and preventive measures.
2) Provide for ICAC and/or Ombudsman to reach out proactively to the private sector to coordinate development of corporate governance, business ethics, and private sector anti-corruption standards.
3) Build on EITI to encourage integrity pacts more broadly, so that additional sectors such as forestry and procurement can adopt standards and mutually police them.

B. Internal controls

The Solomon Islands imposes no legal requirements with respect to internal controls, whether internal audit, audit committees, or internal control and compliance systems. The law does enable companies to set up committees for such purposes, and imposes rules and disclosure requirements on certain related-party transactions.

Recommendations

1) Support awareness and training on corporate governance and internal control issues. Encourage international companies to participate in knowledge transfer.
2) Adopt a corporate governance code that covers internal control, audit committees, internal audit, and related matters. This could

initially be voluntary, but then should be accompanied by regulatory standards and pressure, and eventually legal enforcement, for public companies. Phase in specific legal requirements and standards.

C. Integrity of financial statements

The Companies Act addresses the keeping of account books and documents, but does not stipulate a legal retention period. There are provisions against false statements in the law, but no prohibitions on the usual methods of accounting record manipulation associated with hiding bribery and fraud. Financial statements must be prepared by all companies, but only public companies and banks must file them with signatures and audit reports attached. Rules for consolidation and for reporting by foreign companies are in place, but IFRS have only been partially adopted. Companies are to have their financial statements audited annually, and banks must use Central Bank-approved auditors and publish their audited financials. Auditors have the right to access all necessary documents and to demand information and explanations from the company. It is not clear what audit standards are applied in the Solomons. Auditors have neither a duty to report fraud and corruption, nor a safe harbor protection from liability for such reports. Instead, ministers may appoint investigators if there are indications of such practices or if requested by the shareholders or regulator – a process that appears less likely to restrain corruption than the alternative of requiring the auditor to report to management and to external authorities. The accounting and auditing profession is still fairly early in its development in the Solomon Islands, and is governed by the member-based Institute of Solomon Islands Accountants. Safeguards of auditor independence are less demanding than in best international practice, a situation perhaps motivated by the small numbers of qualified practitioners. The enforcement provisions for the financial reporting and auditing rules include very light fines, prison terms, and light fines imposed on companies.

Recommendations

1) Adopt a mandatory retention period for company financial records of at least seven years, and prohibit the range of record manipulation practices, such as off-the-books transactions, associated with concealment of corruption.
2) Follow through on adoption of IFRS and auditing standards, namely ISA, for public companies (i.e. those not defined by law as private). Audits should cover internal controls (or state their absence).
3) Consider replacing the provision for appointment of investigators of illegality, fraud, or corruption with a requirement and protection for the auditor to report these matters to management and external authorities.

4) Phase in tighter safeguards for independence of external auditors, independent agency oversight of professional discipline, as well as higher fines for financial reporting and auditing offenses.

Solomon Islands Laws, Regulations, Policy Documents Referenced:

Accountants Act No. 7 of 2010, http://www.parliament.gov.sb/files/legislation/Acts/2010/Accountants%20Act%202010.pdf.

Central Bank of Solomon Islands, Financial Market Supervision Department, *Prudential Guideline No. 4: External Audit Requirements*, http://www.cbsi.com.sb/fileadmin/prudential_guidelines/No4-External_Audit_Requirements.pdf.

Laws of Solomon Islands (1996) Chapter 48 Banking, http://www.paclii.org/sb/legis/consol_act/ba72/.

Laws of Solomon Islands (1996) Chapter 175 Companies, http://www.paclii.org/sb/legis/consol_act/ca107/.

NOTES

[1] http://www.commonwealthofnations.org/sectors-solomon_islands/business/, http://www.dfat.gov.au/geo/solomon_islands/solomon_islands_brief.html, http://www.ramsi.org/our-work/anti-corruption.html.

[2] See "The RAMSI Decade: A Review of the Regional Assistance Mission to Solomon Islands, 2003 – 2013," an independent report commissioned by the Solomon Islands Government and the Pacific Islands Forum.

[3] http://www.dfat.gov.au/geo/solomon_islands/solomon_islands_brief.html.

[4] Currency conversions are at the inter-bank rate as of April 12, 2014, http://www.oanda.com/currency/converter/.

[5] This is the Political Party Integrity Act, adopted in 2014. The Political Party Integrity Commission has been established to oversee implementation.

[6] http://www.ramsi.org/our-work/anti-corruption.html; government comments.

[7] http://www.ramsi.org/our-work/economic-governance/economic-reform.html.

[8] http://www.ramsi.org/our-work/machinery-of-government/accountabililty.html.

[9] This body has apparently taken on different names since its establishment.

[10] http://www.ramsi.org/our-work/anti-corruption.html.

[11] The Solomon Islands has produced its EITI Report for 2012 – 2013, see http://www.mof.gov.sb/ReportsNew/ExtractiveIndustriesTransparencyInitiative.aspx, http://eiti.org/solomon-islands, http://www.mof.gov.sb/ReportsNew/ExtractiveIndustriesTransparencyInitiative.aspx, http://www.solomonstarnews.com/news/business/3458-si-eiti-pushes-for-revenue-transparency-in-mining-sector.

[12] The sources of all standards are provided in footnotes to the tables presented in the section of the Review entitled *International Standards for Country Reports.*
[13] Laws of Solomon Islands (1996) Chapter 175 Companies, http://www.paclii.org/sb/legis/consol_act/ca107/.
[14] Laws of Solomon Islands (1996) Chapter 48 Banking, http://www.paclii.org/sb/legis/consol_act/ba72/.
[15] http://www.adoptifrs.org/CountryDescription.aspx?CID=192.
[16] http://www.commonwealthofnations.org/sectors-solomon_islands/business/accountancy_audit_and_tax/, http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-solomonislandshighlights-2014.pdf.
[17] Central Bank of Solomon Islands, Financial Market Supervision Department, *Prudential Guideline No. 4: External Audit Requirements*, http://www.cbsi.com.sb/fileadmin/prudential_guidelines/No4-External_Audit_Requirements.pdf.
[18] http://www.commonwealthofnations.org/sectors-solomon_islands/business/accountancy_audit_and_tax/.
[19] Accountants Act No. 7 of 2010, http://www.parliament.gov.sb/files/legislation/Acts/2010/Accountants%20Act%202010.pdf.

Sri Lanka

1. Introduction

Since the end of its civil conflict in 2009, Sri Lanka has adopted policies that support impressive levels of growth and investment, building upon earlier tax and company law reforms.[1] High levels of literacy and an active civil society contribute to pressure for good governance. On the other hand, the World Economic Forum's Global Competitiveness Report 2012-2013, cites policy instability and corruption as being among the obstacles to doing business in Sri Lanka.[2]

2. General efforts to prevent corruption involving the private sector

A. Public-Private Cooperation

There are certain public-private initiatives to prevent corruption, but not a broad, inclusive effort to strengthen integrity in government and the private sector. Data from Sri Lankan and international businesses suggest a lack of trust between private and public sector that will take time to overcome. According to the World Bank/IFC Enterprise Survey for Sri Lanka, a number of companies surveyed in 2011 reported that they expected to provide unofficial payments or gifts to secure government contracts.[3] In the same surveys, bribery was reported to exist as well in connection with public utilities and the awarding of licenses. Thus, international observers counsel due diligence in the context of any such undertakings in Sri Lanka.[4] Yet, both the government and the private sector report that joint efforts are being made to enhance integrity and transparency in the private sector.

There have been joint initiatives to improve corporate governance and financial reporting. For example the Institute of Chartered Accountants of Sri Lanka (CASL) and the Securities and Exchange Commission (SEC), in consultation with the Colombo Stock Exchange, jointly developed standards on corporate governance for companies listed on the exchange. The standards were formulated by a select committee, which took account of corporate governance standards in several countries.[5]

International standard[6]	Compliance by member country
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	Some efforts underway.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) No such provisions. 2) In practice, self-reporting and preventive measures by companies are considered as mitigating factors in cases of corruption and financial reporting offenses.
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) and 2): No such activities reported. 3) Joint initiative (2007) by CASL, SEC, Colombo Stock Exchange to formulate corporate governance standards.
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	No such initiatives.

3. Internal Controls, Ethics, and Compliance

A. Internal audit

Internal audit is practiced by companies in Sri Lanka although it is not explicitly required by law. Internal auditing is in a developmental phase, with IIA-SL seeking to raise standards by enabling professionals to qualify as Certified Internal Auditors (CIA), a credential recognized internationally. IIA-SL also organizes conferences and trainings, and maintains a professional library.[7] Though it is not required by law, most of the large and listed companies do have internal audit units with significant authority.[8]

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	Internal audit practiced though not expressly required by law. Sufficiency for corruption detection is uncertain.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect “illegal acts” in the books and records of companies, including bribery and other forms of corruption.	1) No formal internal auditing profession. Institute of Internal Auditors Sri Lanka (IIA-SL) was established as affiliate of IIA (2005) and now has 100 members. 2) No such duty.
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	1) through 4): Basic internal audit is reported to be practiced, but it is unclear to what extent the other components are implemented. There is no express legal or regulatory requirement for companies to establish an internal audit function.

B. Audit committee

The Corporate Governance Code (art.D.3) recommends that all public companies should have an audit committee and provide it with written terms of reference spelling out in detail its authority and duties (SEC-CASL 2008). The provisions discussed here follow most international standards as presented in the table below. Audit committees are *required* for listed companies only.

Where a parent company and its subsidiary are both listed, the parent company's committee may function for both (SEC 2010: 9-10). There is no general legal requirement for other kinds of companies (e.g. large but not publicly owned) to establish audit committees.

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	1) Corporate Governance Code (art.D.3) recommends that all public companies should have an audit committee. SEC's Listing Rules require listed entities to have audit committees. 2) Listed company audit committees must have a minimum of two independent non-executive directors – or a majority of independent directors – one of whom is to serve as chairman. One member of the committee should be a member of a recognized professional accounting body.

Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers. employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	Corporate Governance Code (art.D.3) recommends that audit committees should have terms of reference, including: 1) Audit-related: • Discuss company financial statements and disclosures with the auditor. • Review audits of the company and ensure the independence and objectivity of the auditors. • Make recommendations to the board on the appointment of auditors and on audit planning. • Meet periodically with management and internal auditors, set controls for non-audit work of the auditor, and report regularly to the board of directors. 2) Assist the board with oversight of financial reporting and of internal controls and risk management procedures. 3) No requirement 4) and 5): Establish procedures for the confidential receipt and treatment of complaints alleging fraud, and ensure confidentiality to whistle-blowing employees.

C. Internal control and compliance systems

As regards internal controls, ethics codes, and compliance systems Sri Lanka provides standards of a voluntary, quasi-regulatory nature in the Corporate Governance Code. Private sector survey responses suggest that these controls are often followed as good practice. The Sri Lankan standards do not require a risk-based approach to developing internal controls. Further, the internal control norms do not explicitly call for a “tone at the top” emphasizing integrity, or mechanisms to train and reinforce this throughout the company. The Code may serve as a guide to all companies, but it is mainly applicable to public and listed companies, since the government sponsor of the Code is the SEC.

The Corporate Governance Code states that companies *must* adopt a code of business conduct and ethics for directors and senior management. Enterprises must disclose whether they have such a code of conduct, and include a declaration in the annual report as to whether all directors and members of the senior management team have complied. The annual report should also contain a "Corporate Governance Report," explaining the manner and extent to which the company has complied with the principles and provisions of the Corporate Governance Code (SEC-CASL 2008: D4, D5). The substantive provisions on internal control do not prescribe specific measures dealing with the risk of bribery in such areas as gift-giving and the use of third-party agents.

International standard	Compliance by member country
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees. 4) Risk-based approach: • Individualized assessment of risks to the enterprise, including corruption risks. • Regular monitoring and re-assessment of corruption risks.	1. Corporate Governance Code (art.D.2) encourages company boards to maintain a sound system of internal control to safeguard shareholder interests and company assets. 2. Audit committee should conduct an annual review of the effectiveness of the internal controls. The Directors' Report (part of the Annual Report), should state that the directors have conducted a review of the internal controls covering financial, operational, and compliance controls and risk management, and have obtained reasonable assurance that the controls are effective and the company is in compliance. Audit standards call for testing the internal controls (see below). 3. and 4): No provision.

Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements. 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations. 4) Require for third-party representatives, consultants, or agents: • Written contract, adherence to company ethics standards and anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	Corporate Governance Code states that companies should address key topics in their internal codes, including: 1) Conflict of interest, confidentiality, compliance with laws and regulations, and the reporting of illegal or unethical behavior. 2) through 4): No requirements.
Enforcement, including sanctions for failure to comply.	No enforcement provisions.

4. Integrity of Financial Statements

A. Accounting

1. Financial records

All companies in SL must be registered under the Companies Act (No.7 of 2007). The Act requires all companies to maintain accounting records that correctly detail the company's transactions, enabling the financial position of the company to be determined with reasonable accuracy at all times, and providing the basis for preparation of financial statements and for proper audits. Certain additional requirements are imposed on different sectors of operation (e.g. invoices and service records for service firms). Financial records are to be kept in written form or in a manner that allows the documents and information that comprise the records to be easily accessible and convertible into written form.

The company must take sufficient steps to prevent the records from being falsified, and to detect any falsification (see the table below).

These requirements are comparatively strict and comprehensive, and they apply to all registered companies – i.e. all enterprises covered by the Companies Act. What they do not address explicitly is the prohibition of accounts and transactions that are off the books. The latter should be covered (though not expressly) by art. 151 of the Act, requiring each company to prepare financial statements that "give a true and fair view of the state of affairs of the company and the profit or loss or income and expenditure." These issues are also broadly covered by the financial reporting standards (see below). More specific wording, of course, is preferable in ensuring coverage.

International standard	Compliance by member country
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	All companies registered under Companies Act required to maintain written accounting records that enable the financial position of the company to be determined accurately. Copies of financial statements, accounting and other records must be kept for ten years.[9]
Prohibitions (UNCAC 12(3), OECD Convention 8(1), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	Prohibitions: 1) and 2) Destroying, falsifying, or altering accounting records – or being a party to any such actions. 3) and 4): No explicit prohibition. 5) and 6) Making false entries or wilfully making a statement in the accounts that is false in any material particular.[10]

2. *Financial reporting requirements*

Sri Lanka has adopted IFRS and the special IFRS for SMEs, effective January 2012. Some modifications were included in the incorporation of the IFRS as the Sri Lanka Accounting Standards (SLFRS), and the implementation of a few standards was deferred. The SLFRS apply to all firms in the category of Specified Business Enterprises (SBEs) as defined in the Sri Lanka Accounting and Auditing Standards Act (No. 15 of 1995).[11] These include listed companies, financial institutions, investment-related firms, and some other large or public companies. All SBEs are required to use full SLFRSs even if their securities do not trade in a public market. Companies other than SBEs are given the option to adopt full SLFRSs or the SLFRS for SMEs.[12] Sri Lanka has not taken the further step beyond the IFRS to impose rules that explicitly ban the disguising of bribes in company accounts or include possible effects of corruption in the definition of materiality.

SBE financial reports are subject to two layers of scrutiny. These companies must submit their annual audited financial statements to the SLAASMB, which monitors compliance with Sri Lankan accounting and auditing standards. Under the Accounting and Auditing Standards Act, the Board has investigative authority and power to compel information and testimony. In 2011, the Board reviewed the financial statements of a sample of 195 companies out of a total of 1,256 SBEs identified at that time. Nine of these enterprises were found to have significant errors in their financial reporting and entered agreements to make corrections.[13] The SEC also has a Financial Reporting Surveillance Program, under which it reviews the financial reporting practices of listed companies for compliance with the SLFRS. In 2010, the Program reviewed 109 companies and found violations that resulted in 39 Letters of Comment and five Letters of Caution (SEC 2010: 3-11). Sri Lanka is to be commended for carrying out such oversight, but since violations are so numerous, they merit further analysis and public discussion.

International standard	Compliance by member country
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) IFRS adopted as SLFRS and applied to SBEs: • Companies listed on a stock exchange • Financial institutions • Factoring and leasing companies • Investment entities such as unit trusts and fund management companies • Stockbrokers and stock exchanges • Public corporations engaged in sale of goods or provision of services • Companies meeting size threshold [14] 2) Special IFRS for SMEs apply to other companies. 3) IFRS 10 deferred to January 2014. Consolidated financial statements must meet SLFRS (or SME SLFRS). Off-balance sheet transactions and special-purpose entities not included.[15]
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) IAS 37: materiality concerns impact on financial position. IAS 37.86: Disclosure of possible outflow required unless possibility is remote. Reported practice is normally not to disclose. 2) No explicit prohibition. Implied by IFRS (e.g. IAS 1.15).

B. Audit

1. Auditing requirements

The Sri Lanka Auditing Standards (SLAuS) are based on International Standards on Auditing (ISA) with slight modifications to meet local conditions and needs. CASL states that compliance with the Sri Lanka Auditing Standards "ensures compliance in all material respects with the International Standards on

Auditing." Under the Accounting and Auditing Standards Act, compliance with these Standards is compulsory for audits of SBEs. The Act places responsibility of complying with the SLAuS not on the auditors alone, but also on the entity's management.[16]

The Accounting and Auditing Standards Act requires SBEs to submit their annual audited financial statements to the SLAASMB, which monitors compliance with standards. SLAASMB reports having reviewed 30 audits carried out by 17 firms during the year 2011. The Board found that audit documentation in the majority of cases did not provide a sufficient basis for the auditors' reports. Deficiencies were found in 19 of the audits, including failure to identify material misstatements, and the Board reported its concerns to the audit firms (SLAASMB 2011). As in the case of financial reporting oversight discussed above, Sri Lanka is to be commended for monitoring audit quality, but the causes and consequences of the noted deficiencies merit public discussion.

The Companies Act provides the minimum standards applicable to all registered business entities. The auditor is to issue an opinion as to whether the financial statements give "a true and fair view of the matters to which they relate and if they do not, the respects in which they fail to do so" (art.163). The auditor must also report the basis of this opinion, explaining whether the auditor has obtained all the required information, and whether proper accounting records have been kept by the company. On the side of the company, it is responsible for ensuring that the auditor has access to all accounting records and other documents of the company, and to provide the auditor any information and explanations she/he deems necessary (art.164).

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	Auditing control requirements are substantial but not fully sufficient for anti-corruption purposes.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	1) Accounting and Auditing Standards Act mandates that all SBEs must have financial statements audited by professional members of CASL.[17] 2) Companies Act requires annual audit. Registrar may appoint an auditor for non-compliant company (art.154).

Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	SLAuS based on ISA with slight modifications, and include ISAs 240 and 250.
Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks. 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	1) Companies Act (arts.150-153) requires auditors to certify that the audit has been conducted, and the financial statements prepared and presented, in accordance with Sri Lankan accounting and auditing standards (SLFRS and SLAuS).[18] Auditor must provide opinion as to whether financial statements give "a true and fair view" (art.164). SLAuS 400: Auditor should test internal systems, e.g. by inspecting documents, observing internal controls that leave no audit trail, and repeating internal control processes. 2) Company financial statements must be certified by the person responsible for their preparation as being in compliance with the Companies Act (arts.150-153), and signed by two directors. Company must ensure that auditor has access to all accounting records and other documents of the company, and provide the auditor any needed information and explanations (art.164).

2. Auditor reporting of improprieties

In Sri Lanka, there is limited provision for the reporting of any illegality or corruption that comes to light in an audit. The Companies Act (art.161) requires an explanation in the case of an auditor's resignation, which is then to be forwarded to each shareholder and to the Registrar of Companies. ISA 240 and ISA 250 have been incorporated as SLAus 240 and 250 respectively. As in other ISA jurisdictions, audit reports in Sri Lanka must address risks of fraud or non-compliance with laws leading to material misstatements. But the SLAuS do not provide the auditor a basis to report improprieties to the authorities. There are, however, some alternative options. She/he may consult legal counsel or request a letter from management with representations or explanations concerning the auditor's finding of fraud or mistake. Or, in the case of legal non-compliance, if the auditor concludes that this 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 adverse opinion.[19]

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	Limited provision for reporting. SLAuS 240 and 250 address risks of fraud or non-compliance with laws leading to material misstatements. Companies Act (art.161), requires auditor to explain resignation, including any relevant circumstances that should be brought to the attention of shareholders, etc.
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").	1) A limited duty of external reporting exists. A company is required to send copies of an auditor's statement under Companies Act (art.161) to each shareholder and to the Registrar of Companies. 2) No "safe harbor" or statutory exception to the duty of confidentiality is provided.

C. Professional standards and independence

The Sri Lanka Accounting and Auditing Standards Monitoring Board (SLAASMB) enforces practice standards on the accounting profession. The Board reviews financial statements and audits, conducts investigations of failures to comply with standards, and takes corrective action with regard to deviations from standards by companies and auditors. The Board maintains relations with relevant international organizations including IFAC. In cooperation with the Board, CASL serves as the main professional governing body responsible for policy formulation, professional qualification, and ethical standards.[20]

The Companies Act (arts.154-162) deals with independent auditor appointments. Several categories of persons are prohibited from serving as external auditors (e.g. anyone having served as a director or employee of the company within the last two years). The independent auditor is to "ensure that his judgment is not impaired by reason of any relationship with or interest in the company or any of its subsidiaries" (art.162). This provision discourages auditors from investments in audited firms but does not prohibit them. The lack of a prohibition does not comport with international good practice, and indeed contrasts with the Guidelines for listed companies (see below). An auditor is to be automatically re-appointed unless she/he resigns, is disqualified, or is removed by shareholder resolution – and must be given the opportunity to make representations if she/he opposes being replaced. An auditor who resigns is required to provide the company a statement of any circumstances connected with the departure that should be brought to the attention of shareholders and creditors.

In addition, the SEC has published voluntary Guidelines for Appointment of Auditors of Listed Companies" (SEC 2008). All companies listed in the Colombo Stock Exchange are "encouraged" to implement them. The guidelines address such issues as minimum qualifications for auditors and audit firms and rotation of the responsible audit partner after five years (with a two-year hiatus). A cap (10% for the year) is imposed on the share of an auditor/audit firm's fees paid by a single listed company or its parent, subsidiaries, or affiliates. A list is provided of non-audit services that should not be performed by the auditors in the same year as the audit. A two-year cooling-off period should be observed before members of the audit team (or partner of the audit firm) can be employed by the audited company. The audit firm partners and engagement team members should not hold any financial (or other) interest in the audited company, and audit firm managers (and relatives) should divest any stocks within a year of the audit engagement (art.3.2). The guidelines for avoiding conflict of interest extend to the parent company, subsidiaries, and affiliates of the audited company.

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) Accounting profession supervised by SLAASMB. CASL administers qualifying examinations, prescribes courses of study, supervises training. 2) CASL oversees ethical standards. [21]
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited	1) All companies must use registered auditors and all public companies must appoint auditors who are members of CASL. 2) Listed company guideline: restriction on non-audit transactions, payments, services involving the company and the audit firm. Non-audit services that should not be performed by the

firms. 5) Companies' employment of former auditors.	auditors in the same year include bookkeeping, internal audit, brokerage and legal services, management functions. 3) Listed company guideline: rotation of responsible audit partner after five years (with a two-year hiatus). 4) Prohibited from serving as external auditors: anyone having served as director, employee, or liquidator of the company within the last two years. Audit firm partners and engagement team members should not hold any interest in the audited company. Audit firm managers (and relations) should not own or trade in the audited company's stock. 5) Guideline: cooling-off period before employment of former audit firm members by the audited company, and employment of former company officials by the audit firm. [22]
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) Auditing professionals supervised by SLAASMB. CASL administers qualifying examinations. 2) CASL prescribes courses of study, supervises training and ethical standards. 3) and 4): SLAASMB reviews performance of audits, is responsible for discipline.[23]

D. Enforcement

Sri Lanka's standards for accounting, financial reporting, and audit are enforced by the Company Registrar and SLAASMB, working with the SEC, the Inland Revenue Department, or the state prosecutors depending on the case. In addition to fines for various offenses, willful manipulation of financial information is subject to imprisonment for the responsible individual.

Under the Accounting and Auditing Standards Act, SLAASMB has the duty to bring violations to the attention of the relevant authorities for enforcement including prosecution. An individual convicted of an offense under the Act carried out "with the intention of misleading" shareholders, banks, tax authorities, or other outsiders is subject to a prison term. The penalties for financial reporting violations also apply where companies fail to cooperate with an external audit or engage in manipulations related to it, or if an auditor colludes in disguising illegalities. When a corporation is guilty of an offense under the Act, any director, manager, secretary or other similar officer will also be deemed guilty unless she/he "proves that the offence was committed without his knowledge or connivance and that he exercised all such diligence to prevent the commission of that offence." [24]

These penalties appear in principle to provide some deterrent effect. On the one hand, the fines are relatively low, and need to be increased. On the other hand, several factors appear to counterbalance this weakness. The prison terms specified are potentially quite strict. The combination of corporate and individual responsibility helps to ensure consistent application, especially if corporate-level offenses result in penalties to individuals. Finally, the requirement that financial statements must be signed and certified heightens the duty of care applicable to corporate officers.

International standard	Compliance by member country
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2):. A combination of prison terms and liability for both companies and individuals is counterbalanced by low fines. Thus, there is some deterrent effect but this appears to need strengthening.

Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) and 2): Fines up to SLR 200,000 (USD 1,500) on company and officers for failure to keep proper accounting records, to keep records in the proper form for the retention period, or to sign and certify accounts. Fines up to LKR 1 million (USD 7,600) and/or imprisonment up to five years for willful falsehood or fraudulent alteration or destruction of financial records. Fines up to LKR 500,000 (USD 3,800) per person for accounting or audit standard violations, imprisonment up to five years if done with intent to deceive outside stakeholders.[25] 3) Enforcement by the Company Registrar and SLAASMB, working with the SEC, the Inland Revenue Department, or the state prosecutors.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) and 2): Fines up to LKR 100,000 (USD 750) per person for failure to provide information to auditor – including each director of a company found at fault. Fines up to LKR 200,000 (USD 1,500) for auditor's failure to report financial statement issues upon resignation, and for every corporate officer responsible if such report not forwarded to shareholders and Company Registrar – including each director of a company found at fault.[26] 3) As above.

5. Conclusion and Recommendations

A. General efforts to prevent corruption involving the private sector

Joint efforts by the public and private sector are in need of improvement, and opportunities for this should not be hard to identify. The joint development of the Corporate Governance Code provides a model here. The intention of the promoters was apparently to phase in the Code as a voluntary instrument, and then to adopt it as a set of mandatory standards. It appears that the latter step has not yet been taken, and thus efforts should be made to hasten the process. The Code effort shows that institutions such as the SEC and CASL can bring public and private sectors together. An area of possible focus that has not yet been developed in Sri Lanka is the integrity pact – we recommend that models be developed here and disseminated to encourage their use in business sectors.

Recommendations

1) Increase public-private efforts to prevent corruption, including such mechanisms as cooperative partnerships between government and companies.
2) Formalize sentence-mitigation provisions in corruption laws, and provide a channel for self-reporting by companies.
3) Encourage or sponsor integrity pacts, and anti-corruption codes and seminars for companies.

B. Internal Controls, Ethics, and Compliance

The Corporate Governance Code provides guidelines for internal audit and control functions. These standards are largely voluntary rather than mandatory, and do not directly address corruption risks. Concerning internal controls, the Code falls short on such matters as “tone at the top” and risk-based measures to deter bribery. As for the voluntary nature of the Code, as in several other countries, it may well be the right approach to phase it in as a voluntary instrument. But it is clear that internal audit, along with internal control and compliance systems, are parts of international good practice that should be required of Sri Lankan companies with a public interest dimension. This requirement can be phased in for the SBEs and then expand to other companies as appropriate.

Recommendations

1) Make compliance with the Corporate Governance Code mandatory for all public companies and large private companies, beginning with SBEs. Include in the text provisions on prevention of bribery and other forms of corruption. Requirements should include audit committees with terms of reference as defined in the Code, an internal audit function, and policies and procedures for internal control that meet international standards.
2) Develop mandatory internal audit standards (based on international standards including IIA) and phase them in with expansion of the Corporate Governance Code as above. The internal auditor duties should include detecting illegalities and corruption risks.
3) Require internal control and compliance systems, phasing them in as above. These should include affirmative steps by management to ensure support across the company, training in ethics and control procedures, risk-based system design and monitoring, the duty of all personnel to prevent bribery, and standards for dealing with gift-giving and third-party agents.

C. Integrity of Financial Statements

Accounting and audit standards are reasonably well-developed and largely in conformity with the international standards, with a few exceptions. The fact that financial accountability processes are overseen to varying degrees by SLAASMB, CASL, and the SEC is quite positive, at least potentially, in exerting discipline. Also, Sri Lanka takes a proportionate approach in limiting to SBEs the requirements to use CASL-qualified auditors and the full SLFRS and SLAuS. The SME version of the financial reporting standards is available to smaller firms, and enterprises that are not formalized as companies do not appear to have accounting or audit requirements beyond what may be imposed by the tax code and other rules. Also, while specified prison terms and combined individual and corporate liability for accounting and audit offenses provide some deterrence, it is desirable to increase the fines and to enable periodic adjustment.

Recommendations

1) Tighten accounting and financial reporting rules. Prohibit off-the-books accounts and transactions, and any disguising of corruption by means of accounting. Consider including the possible losses due to corruption in the definition of "materiality" for financial reporting purposes. Phase in SME financial reporting standards for non-SBE companies.
2) Make the Guidelines for Appointment of Auditors mandatory for all SBEs, and then extend them to all public companies. Specifically, the standards restricting audit firm members' financial interests in audited firms should be legally mandated with respect to all company audits.
3) Require public reporting and analysis of problems found in SLAASMB and SEC reviews. Provide a legal basis for internal and external reporting of corruption, fraud, and illegalities by external auditors – including a "safe harbor" and duty to report.
4) Use accounting and audit rules to combat corruption, adjusting standards as above and ensuring enforcement. Increase fines – for both companies and individuals - for violations in the accounting, financial reporting, and audit fields, and enable their adjustment for inflation.

Sri Lanka Laws, Regulations, Policy Documents Referenced:

Companies Act (No.7 of 2007), www.drc.gov.lk/App/comreg.nsf/200392d5acdb66c246256b76001be7d8/$FILE/Act%207%20of%202007%20(English).pdf.

SEC (2008), "Guidelines for Appointment of Auditors of Listed Companies," Securities and Exchange Commission of Sri Lanka, http://www.sec.gov.lk/?page_id=141&lang=en.

SEC-CASL (2008), "Code of Best Practice on Corporate Governance," Securities and Exchange Commission of Sri Lanka and Institute of Chartered Accountants of Sri Lanka, http://www.sec.gov.lk/?page_id=141&lang=en.

SEC 2010, "Financial Reporting Surveillance Programme," Securities and Exchange Commission of Sri Lanka, http://www.sec.gov.lk/?page_id=141&lang=en.

SLAASMB (2011), "Annual Report 2011," Sri Lanka Accounting and Auditing Standards Monitoring Board, http://www.slaasmb.org/Annual%20Reports.html.

Sri Lanka Accounting Standard – LKAS 37: Provisions, Contingent Liabilities and Contingent Assets, http://www.casrilanka.com/casl/images/stories/content/publications/publications/accounting_standards/bound_volume/lkas_37.pdf.

Sri Lanka Auditing Standard 250: Consideration of Laws and Regulations in an Audit of Financial Statements, www.casrilanka.com/casl/images/stories/content/publications/publications/sri_lanka_auditing_standards/currently_applicable_sri_lanka_auditing_standards/slaus_20250.pdf.

The Sri Lanka Accounting and Auditing Standards Act (No. 15 of 1995), www.commonlii.org/lk/legis/num_act/slaaasa15o1995425/

NOTES

[1] BTI (2012), “Sri Lanka Country Report,” Bertelsmann Stiftung Transformation Index, www.bti-project.de/fileadmin/Inhalte/reports/2012/pdf/BTI%202012%20Sri%20Lanka.pdf, p.15-21.

[2] www.business-anti-corruption.com/country-profiles/south-asia/sri-lanka/show-all.aspx

[3] The “Country Profile” reports 15%, while the data set reports nearly 30%; http://www.enterprisesurveys.org/~/media/GIAWB/EnterpriseSurveys/Documents/Profiles/English/sri-lanka-2011.pdf, http://www.enterprisesurveys.org/data/exploreeconomies/2011/sri-lanka. The comparable figures for surveyed firms expecting to give such gifts to secure contracts were 26% for all countries in the survey, and 36.5% for South Asia as a whole.

[4] www.business-anti-corruption.com/country-profiles/south-asia/sri-lanka/show-all.aspx

[5] www.business-anti-corruption.com/country-profiles/south-asia/sri-lanka/show-all.aspx

[6] The sources of all standards are provided in footnotes to the tables presented in the section of the Review entitled *International Standards for Country Reports.*

[7] http://www.iiasl.lk/

[8] Government comments.

[9] Companies Act (arts.116-118, 148). The Securities and Exchange Commission also imposes a five-year record retention period, and a six-year requirement for market intermediaries,www.sec.gov.lk/wp-content/uploads/SECSL-Rules-2001.pdf, www.sec.gov.lk/?p=413&upm_export=pdf.

[10] Companies Act (arts.511-512).

[11] www.commonlii.org/lk/legis/num_act/slaaasa15o1995425/.

[12] www.ifrs.org/Use-around-the-world/Documents/Jurisdiction-profiles/Sri-Lanka-IFRS-Profile.pdf.

[13] SLAASMB (2011), www.slaasmb.org/rightframe1.html.

[14] Regulations bring some additional companies into the category of SBEs based on size. These include companies (and groups of related companies) with turnover in excess of SLR 500 million (USD 3.8 million), shareholder equity in excess of SLR 100 million (USD 763,796), gross assets in excess of SLR 300 million (USD 2.3 million), or a staff in excess of 1000 employees, www.slaasmb.org/rightframe1.html.

[15] Companies Act, arts.150-153 (pending application of IFRS 10).

[16] www.casrilanka.com/casl/index.php?option=com_content&view=article&id=236&

Itemid=56&lang=en. Government comments point out that comprehensive audits are carried out by the internationally reputed firms for the main corporates, and best international practices used in such cases.

[17] www.slaasmb.org/rightframe1.html

[18] www.slaasmb.org/rightframe1.html

[19] SLAus 250, www.casrilanka.com/casl/images/stories/content/publications/publications/sri_lanka_auditing_standards/currently_applicable_sri_lanka_auditing_standards/slaus_20250.pdf

[20] Other bodies such as the Sri Lanka chapter of the Chartered Institute of Management Accountants also perform similar functions, www.cimaglobal.com/Our-locations/SriLanka/.

[21] Sri Lanka Accounting and Auditing Standards Act No. 15 of 1995, www.commonlii.org/lk/legis/num_act/slaaasa15o1995425/; www.casrilanka.com/casl/.

[22] Companies Act (arts.157-162); SEC (2008: secs. 2, 3).

[23] Sri Lanka Accounting and Auditing Standards Act; SLAASMB (2011).

[24] www.slaasmb.org/rightframe1.html.

[25] Companies Act (arts. 116, 148, 511, 512); Accounting and Auditing Standards Act, www.slaasmb.org/rightframe1.html.

[26] Companies Act arts.161, 164.

Timor-Leste

1. Introduction[1]

Timor-Leste is one of the world's youngest democracies. In recent years, it has also been one of the world's fastest-growing economies, buoyed by revenues from its modest petroleum resources. It remains, however, one of the poorest countries in the Asia-Pacific region, and its population of some 1.1 million is growing rapidly. Agriculture plays an important part in the Timorese non-oil economy, accounting for over 30% of GDP and around 75% of employment. Timor-Leste has established an internationally-acclaimed Petroleum Fund to manage its petroleum revenues transparently and sustainably. As of mid-2013, the fund was valued at USD 13.6 billion. The government is seeking to use its oil revenues in support of sustainable long-term economic development, economic diversification and poverty reduction. Timor-Leste faces a range of economic development issues including high unemployment and underemployment rates and low social development indicators, especially in health and education. Government spending, largely on infrastructure and social transfers, drives economic growth. Private sector development has been slow due to human capital shortages, an incomplete and bureaucratic regulatory environment, and basic infrastructure inadequacies, notably in the areas of transportation, telecommunications, and electricity.[2] In addition, Timor-Leste remains a challenging business environment, with the IFC ranking it 168 (out of 183) in the 2012 *Ease of Doing Business* Survey. The government is attempting to address this, establishing in 2013 a one-stop shop for both foreign and domestic investors to register their businesses. A more recently published report shows that Timor-Leste, with the other economies in the g7+ group, has improved its business regulatory environment since 2005, thus beginning to narrow the gap with the best performers globally.[3]

Timor-Leste secured the formal restoration of its independence in 2002, with a constitution providing for an elected President as head of state and a Prime Minister appointed from the majority party or alliance in the unicameral parliament. Timor-Leste experienced major instances of political violence in 1999 in the wake of the referendum on independence from Indonesia and again in 2006 when internal civil order collapsed. The security situation has improved considerably in recent years and the last international peacekeepers departed at the end of 2012. In_2012, Timor-Leste held Presidential and parliamentary elections, which led to the establishment of a coalition government led by Prime Minister Xanana Gusmão of CNRT (National Congress for the Reconstruction of Timor), the party receiving the highest vote total. Timor-Leste's legal system is based on civil law, including enactments from the prior Portuguese, Indonesian, and United Nations administrations. Important commercial legislation has been passed since independence, including company law, a commercial registry, and legislation providing further incentives to investors.

The Government of Timor-Leste is seeking to establish an attractive environment for investment. Part of this policy is its establishment of an Investment and Export Promotion Agency.

2. General efforts to prevent corruption involving the private sector

The Government of Timor-Leste has taken a multi-pronged approach to combating corruption since independence in 2002. Early steps here included the establishment of the Office of Inspectorate General in 2002 and the Office of Ombudsman (*Provedor*) in 2005. The Ombudsman's Office was originally charged with promoting good governance, human rights, and justice, and combating corruption. Later, the role of investigating corruption was shifted to the Anti-Corruption Commission. In 2008, the National Parliament ratified the United the United Nations Convention against Corruption (UNCAC).

Since its formal establishment in 2009, the Anti-Corruption Commission (CAC), an independent agency, has referred several cases to the Office of the Prosecutor General, and has several ongoing investigations. The CAC undertakes preventive and criminal investigations against corruption as a specialized law enforcement body. In terms of investigation, the CAC has no power to investigate private sector corruption as such but focuses on the public sector. The Commission has also carried out over 100 prevention and education conferences around the country. The government is working to establish internal discipline and performance standards, and is working with the US on the training of personnel in the justice sector. Bribery is a crime subject to up to four years of imprisonment. Crimes of active and passive corruption are subject to up to 10 and 15 years, respectively, according to articles 292 and 294 of the Criminal Code.[4]

There are several corruption watchdog organizations active in Timor-Leste, both local and international. A recent survey on perceptions of corruption found that 57 percent of Timorese believe corruption is a serious and growing problem, although it ranked behind poverty and unemployment as the principal concerns of citizens.[5] The CAC also has a mandate to engage in public awareness-raising and education on prevention of corruption. The Ombudsman still provides a channel for public complaints, although its mission now focuses on human rights and does not include corruption. The CAC will also have a complaints mechanism, but this was not yet set up as of the latest report.[6] The CAC is empowered to provide witness protection and to conduct sting operations.[7]

Timor-Leste has an active civil society that includes NGOs, activists, and legal watchdogs involved in governance and anti-corruption activities. Also, the Chamber of Commerce and Industry of Timor-Leste, established in 2011, promotes entrepreneurship, provides business services to enhance the capacities of Timorese enterprises, and represents the needs of its members in policy processes and public forums. Its publications include a periodic *Update on Regulations*.[8]

Where public, private, and civic sectors come together in the most significant way is in the Timor-Leste Extractive Industries Transparency Initiative (EITI). Timor-Leste is one of the pioneers of the EITI in Asia and the government has supported the EITI since 2003. Now, about six out of seven dollars spent by the government are withdrawn from the Petroleum Fund. The Fund's reporting requirements and integration with the State budget help ensure transparency. The Timorese EITI Working Group is comprised of stakeholders from government, including representatives of the State Secretariat for Natural Resources, the Central Bank (formerly the Banking and Payments Authority), which controls the Petroleum Fund account to which most revenue is sent, the National Petroleum Authority, and the Ministry of Finance. Industry is represented by three companies, and three NGOs were elected to represent the interests of civil society. The EITI Secretariat, on behalf of the Working Group, has conducted outreach to build the capacity of civil society in this area, which involves training seminars, conferences, and district visits. Members of the Working Group and stakeholders validated the firsts report on the EITI process in 2010.[9]

International standard[10]	Compliance by member country
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	Several efforts underway involving both separate and joint activities of government, private, and civic sectors.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) Ombudsman provides a channel for complaints. CAC corruption-specific complaints system is being established. 2) CAC can provide witness protection and conduct sting operations, but incentives for self-reporting are not clear.
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) CAC has public outreach on corruption prevention as part of its responsibilities. 2) and 3): The major activity here seems to be the EITI.
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	EITI is an international transparency pact monitored by government, companies, and NGOs, and is ongoing in Timor-Leste.

3. Internal controls

A. Internal audit

There appears to be no general legal requirement for companies to carry out internal audit as such, although the other required mechanisms discussed below deal with aspects of the internal audit function.[11] Also, the banking legislation refers to internal audit (see below) without explicitly requiring it as such. The law on money laundering requires an internal audit for compliance purposes.

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	No internal audit requirement as such, though its existence is assumed in some cases (e.g. banks) and is required for purposes of anti-money laundering compliance.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect "illegal acts" in the books and records of companies, including bribery and other forms of corruption.	1) and 2): No organized profession or standards.
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	1) through 4): No legal requirement except under money laundering legislation. Other corporate bodies carry out certain of these functions.

B. Audit committee

The Law on Commercial Companies[12] (arts.41, 43, 66) requires a company to maintain an audit board[13] if it has 10 or more partners or shareholders, issues debentures, is a joint stock company, or exceeds limits to be set in terms of share capital value, income, or other criteria. The audit board is elected and removed by the shareholders, and may be an individual, an audit firm, or a group of three persons. The board performs the functions associated with an audit committee and an external auditor – except in banks, where these functions are separate. Persons who may not serve on the audit board include the company secretary, directors, employees or agents, or a relative of any of these to the third degree. Partners and shareholders are excluded as well (art.67). The board is to be elected or re-elected for a one-year term at the general meeting, and may be removed for cause (after having the opportunity to heard at the meeting) (art.68). The audit board supervises company management, verifies the accuracy of the company's books and its cash and inventory, carries out the audit, and prepares an annual report (art.69). The board has authority to examine the company's books and documents, and to obtain any information and explanations from management or third parties. The board has both the power and the duty to attend general and management meetings that deal with the accounts (art.70). It must meet at least every three months (art.71).

Under the Timorese banking legislation[14] (arts.15, 16, 19), each bank is to establish an audit committee of three members appointed by the general meeting of shareholders for terms of two years. Members of the board of directors (Governing Board) may not serve on the committee. The audit committee's functions are to establish appropriate accounting procedures and accounting controls for the bank, to supervise and (as needed) commission audits of compliance with the procedures, to monitor legal-regulatory compliance and report to the board, and to provide advice and opinions to the board. The audit committee must meet once per quarter, in addition to meetings called by two members or by the Governing Board. The committee's functions are to be stated in the bank's bylaws. The Central Bank may exempt from this and other provisions of the banking legislation any institutions with total deposit liabilities of less than USD 1 million (provided they do not call themselves "banks") (art.2.6). Some further details are provided in the Central Bank's regulation on bank audits[15] (Part V).

In addition to establishing accounting systems and accounting controls for the bank and supervising compliance, the audit committee is responsible for oversight of the bank's internal and external auditors, approving the appointment and dismissal of the internal and external auditors, approving the scope of the audits, and receiving the audit reports. The committee must ensure that management takes appropriate corrective action in a timely manner to address control weaknesses, non-compliance with laws and regulations, and other problems. The committee engages external experts as needed for its functions.

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	1) Per Commercial Companies Law, companies meeting threshold must have audit board. Per Banking Law, banks meeting threshold must have audit committee. 2) Per Companies and Banking Laws: no directors may serve on board/committee. Companies: no employees, shareholders, etc. on audit board.
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers, employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	1) and 2): Per Companies Law: audit board supervises management, reviews records and accounts, performs audit. Per Banking Law: audit committee supervises accounting and audit, approves auditors, monitors legal compliance, and ensures that management maintains adequate controls. Committee functions to be detailed in bylaws. 3) through 5): Law no. 17/2011 imposes some oversight responsibilities related to prevention of money laundering.[16] Otherwise, no legal requirement.

C. Internal control and compliance systems

Timor-Leste has in place legislative provisions on internal control, including requirements to establish relevant committees and avoid conflicts of interest. The Law on Public Companies[17] (art.14) requires each state-owned company to have a monitoring board that supervises company compliance with laws, regulations, and the company charter, and reviews the company's performance and its accounts and financial statements. The board is a three- or five-person group appointed to a four-year term by the Minister of Planning and Finance. There is no similar provision for private sector companies. The Banking Law (arts.15, 16, 19) requires institutions (i.e. non-exempt ones, as above) to establish a risk management committee (or alternatively, separate committees on credit and asset and liability management). The committee is to have three members appointed by the governing board to two-year terms. Its main functions are to establish and monitor implementation of procedures on lending, investment, and related risks, and to monitor compliance with the relevant laws and regulations. The committee is to meet once per month, and its functions are to be detailed in the bank's bylaws.

Regarding conflicts of interest, the Law on Commercial Companies (art.289) prohibits transactions between a company and its directors unless specially approved by the governing board with a favorable opinion by the audit board. The Banking Law (art.22) requires disclosure by managers of any material interests in bank transactions, in writing to the governing board. Criteria of materiality and other procedural safeguards are spelled out. Failure to comply may result in the manager being suspended or removed from office by the Central Bank, or the contract being set aside by a court. In addition, transactions with related persons are prohibited if the terms are less favorable than those for an arm's length transaction (art.29). Further, law no. 17/2011 (art.16) requires banks and other relevant institutions to establish control systems to ensure compliance with anti-money laundering rules.

International standard	**Compliance by member country**
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees. 4) Risk-based approach: • Individualized assessment of risks to the enterprise, including corruption risks.	1) Per Public Companies Law: monitoring board required. Per Banking Law: risk management committee required (unless exempt). No disclosure required, but controls are spelled out by ministry (SOEs) or bylaws (banks). 2) Banks' audit committees to supervise accounting procedures. Testing of controls not mentioned. 3) No requirement. 4) Banks' risk management committees to supervise risk management procedures, which are designed for categories of transactions and clients. No mention of corruption.

• Regular monitoring and re-assessment of corruption risks.	
Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements. 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations. 4) Require for third-party representatives, consultants, or agents: • Written contract, adherence to company ethics standards and anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	1) Public company monitoring board and bank risk management committee to monitor compliance with laws and regulations. 2) through 4): No explicit requirements on corruption, gifts, agents. Commercial Companies and Banking Laws: restrictions and disclosures for related-party transactions.
Enforcement, including sanctions for failure to comply.	Enforcement is by means of ministry and regulator authority to sanction entities or void transactions.

4. Integrity of financial statements

A. Accounting

1. Financial records

The company and banking legislation in Timor-Leste provides for record-keeping but stipulates no minimum retention period. The Law on Commercial Companies (art.81) requires the keeping of accounting books and records, along with books of minutes, registries of shares and liens, and other records. These materials are to be kept at the registered office or other place known to the registrar and updated regularly, and certain of them are to be made available for consultation by shareholders and other interested parties – or, in some cases, copies made. The Banking Law (art.27) imposes similar requirements on banks, also requiring them to keep specific records required by the Central Bank. The records are to include accounting records exhibiting clearly and correctly the state of the bank's business affairs, explaining its transactions and financial position so as to enable the Central Bank to determine whether the institution has complied with the regulations. Law No. 17/2011[18] imposes a minimum five-year retention period for those records required of banks and other companies that fall within the anti-money laundering provisions.

International standard	Compliance by member country
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	Companies and Banking Law require record-keeping, and specify records, but do not impose a retention period. There is a 5-year retention period for records retained for anti-money laundering purposes.
Prohibitions (UNCAC 12(3), OECD Convention 8(1)), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	1) and 2): Transaction reporting and record-retention rules are provided in Law 17/2011. 3) through 6): No explicit prohibitions.

2. Financial reporting requirements

The laws on companies and banking provide for annual financial reporting. The Law on Commercial Companies (arts.83-84) requires companies to compile annual accounts and to prepare a report on the accounting period with a proposed allocation of returns. Small entities not required to have an audit board are exempt. The report, with reference to the accounts, must address management issues, market conditions, costs, and profitability. The report and accounts must be signed by the directors and approved by the shareholders (art.210). The company is liable for damages caused to shareholders by discrepancies between its reporting and the actual state of affairs of the company (art.156). The management and secretary of the company are jointly liable unless they can prove they were not at fault. The Law on Public Companies (arts.25-26) requires SOEs to keep their accounts in order for ongoing budget oversight, and to prepare annual reports, balance sheets, and statements of output, submitting them with the opinion of the monitoring board to the competent minister, and publishing all of the documents in the official gazette. Law 17/2011 imposes duties on companies subject to its money laundering prevention rules to provide transaction details, and these details are to be verified by the Financial Intelligence Unit.[19]

Financial institutions have additional special requirements to meet in this area. The Banking Law (art.31, 33) requires banks to maintain accounts and prepare financial statements that "reflect their operations and financial condition in accordance with consistently maintained international accounting standards." The accounts and statements must reflect the operations and financial condition of the banks' subsidiaries and branch offices on both an individual and a consolidated basis. Banks, including branches of foreign banks, are each required each quarter to publish in a Timorese newspaper a "fair and true summary" of the quarterly balance sheet, and to do the same for the annual balance sheet. In the case of foreign bank branches, the balance sheets are to be published on both an individual and a consolidated basis.[20] Non-bank financial institutions with more than USD 500,000 in deposits are also required by regulation[21] to maintain accounts and prepare annual financial statements "adequate to reflect their operations and financial condition in accordance with generally accepted accounting standards" in a format set by the Central Bank. The institution must submit its audited financial statements along with all auditors' reports and recommendations, along with management's responses, to the Central Bank. The accounts and financial statements, as above, must reflect the state of affairs on an individual and a consolidated basis.

International standard	Compliance by member country
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) Commercial companies meeting a minimal threshold, SOEs, and financial institutions above a threshold must prepare annual financial reports. Bank financial reports to meet international accounting standards, and non-banks to meet generally accepted accounting standards. 2) Small companies and small financial services providers exempt. 3) Financial institution reports to be prepared on individual and consolidated basis. No further detail.
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) and 2): Commercial companies liable for damages to shareholders due to discrepancies between reports and actual state of affairs of the company. Banks to apply international standards, which may include IAS 37. In neither case is disclosure of prospective liability for corruption offenses likely to be required.

B. Audit

1. Auditing requirements

Financial institutions and other companies are subject to differing audit rules, just as the provisions differ for financial reporting. The Law on Commercial Companies (arts.69-70) provides for annual audits by the company audit board. The audit board (whether a group or a single auditor) is to verify the accuracy of the annual accounts and appraisals of assets and liabilities, and prepare an annual report, giving an opinion on the balance sheet, the profit and loss account, the proposed distribution of returns, and the report of the administration. The designated accounting auditor of the board (or the single auditor as the case may be), must "undertake all necessary verifications and examinations for an accurate and complete audit and report on the accounts." In order to carry out its duties, as mentioned above, the audit board has the authority to examine the company's books and documents, and obtain any information and explanations from management or third parties. The board has both the power and the duty to attend general meetings and management meetings that deal with the accounts. The audit board's report (art.85) must state whether the annual accounts and the report of the management are exact and complete, whether they clearly communicate the financial status of the company, and whether they comply with the law and with the company charter. The report must also describe the audit process and results and the appraisal criteria used by management, and it must report any irregularities or unlawful acts. The report must be signed by the directors. Companies that issue bonds or make public offers of shares must, in addition, be audited by an independent audit professional or company – one having no relationship with the company or audit board members (art.86).

The Banking Law (sec.32-33) requires each bank, on the recommendation of the audit committee, to appoint an independent external auditor approved by the Central Bank. The auditor is to assist in maintaining proper accounts and records as directed by the Central Bank, and prepare an annual report with an audit opinion as to whether the financial statements present a full and fair view of the financial condition of the bank. The audit report is also to review the adequacy of internal audit and control practices and make recommendations on them. These same requirements apply to non-bank institutions as well (Instruction No.06/2010, art.25). For banks below an asset threshold to be set by the Central Bank, the annual audit may be done by the bank's internal auditor, provided the latter has ten years' professional auditing experience. In addition to publishing summaries of their balance sheets, the banks must publish the auditor's opinion and the annual report, making copies of the latter available on demand (art.33). It should be noted that the flexibility accorded to the financial institutions to assign external audit, accounting, and in some cases internal audit to the same personnel is not in accord with accepted international practice.

Further, banks are to submit to the Central Bank regular reports (as determined by regulation) on management, operations, liquidity, profitability, and other matters including those of its corporate affiliates, and cooperate with inspectors or auditors appointed by the Central Bank (art.35). The duty to cooperate applies to affiliates and professional service providers as well. The Central Bank regulation on audits (Instruction CPO/B-2000/9) requires bank audits to be done in accordance with ISA.

The Timor Leste EITI report (Coffey International and IPAN 2010: 11-12) states that all firms participating in the Initiative "are audited according to international standards" by independent auditors. In addition, the Petroleum Fund is audited as an independent unit by a major international accounting firm, Deloitte, in accordance with International Public Sector Accounting Standards. The Working Group was satisfied that the EITI standards in this area were met.

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	Audit requirements appear proportionate, but most entities are not required to meet international standards. Effect on corruption is uncertain.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	1) Per Companies and Banking Laws, independent external audit required only for companies issuing shares or bonds to the public, and banks meeting size thresholds. Banks to publish financial statements and audit reports. 2) Other companies above audit threshold to be audited by audit board, otherwise not audited. Banks below threshold may be audited by internal auditor.
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	Audits of banks and EITI participant companies to be done according to ISA – including ISA 240 and 250.

Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks. 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	1) Company audit reports must state opinion on accuracy of financial statements, describe audit process and results, give opinion on management practices, and report irregularities. Bank audit reports must state whether accounts are true and fair, and give opinion on internal audit and control practices. 2) Company financial statements and audit reports must be signed by the directors. Banks must also submit them to Central Bank. Company officers must cooperate with auditor, who has power to demand documents and information. Banks must also cooperate with Central Bank examiners.

2. Auditor reporting of improprieties

Auditors of commercial companies and financial institutions have a duty of confidentiality and also a duty to report irregularities. The Companies Law (art.70) requires the audit board to keep company information confidential, but without prejudice to their duty to report criminal offenses to the public prosecutor. The audit board must also inform management of any irregularities and inaccuracies found in their reviews, and if these are not corrected, inform the general meeting of shareholders (allowing a reasonable time for correction). The audit board at all times "shall act in the interest of the company, the creditors and the public at large, and shall use the diligence of a rigorous and impartial supervisor." Here, the audit board's explicit duties are to protect confidentiality and report irregularities to management and shareholders. The above-mentioned duty to report crimes to the prosecutor seems to derive from general criminal law. It does not address irregularities whose legality is unclear, and its effectiveness as an incentive depends on factors such as the likelihood that non-reporting would be prosecuted as a crime.

Additional, similar, rules apply to the financial sector. The Banking Law (art.20) requires present and past managers, employees, and agents of a bank to keep secret, and not to use, any non-public information gained in the course of their services to the bank. The types of information in question include account and loan balances, business relationships, and transactions by the bank. Disclosure of such information is limited to the Central Bank, auditors, foreign banking supervisors, and judicial authorities when required by law. The external auditor, however, is required to inform the Central Bank about any fraud by the bank or a subsidiary, and any irregularity or deficiency in management or operations likely to result in a material loss for the bank or subsidiary (art.32). This last provision is also applied to non-bank financial institutions by the relevant licensing regulation (Public Instruction No.06/2010). Lastly, Law no. 17/2011 (art.23) requires banks and other companies covered by the Law to report to the authorities if they believe their institutions may be involved in money-laundering or terrorist financing transactions.

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	Duty to report irregularities to company management and shareholders applies to company audit boards per Companies Law, and to external auditors of financial institutions per ISA 240 and 250.
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").	1) Company audit boards have a duty to report crimes to the authorities, and to act in the interests of the company and the public. Financial institution auditors must report to the Central Bank any fraud and any irregularities likely to cause material loss. 2) Duties to report are stated, but there is no explicit safe harbor to protect auditor from liability.

C. Professional standards and independence

Timor-Leste appears to have no formally organized accountancy profession. As in some other small countries with capacity constraints, it seems that accounting and auditing professionals train and qualify in other jurisdictions. Also, the network of big international accounting firms has a presence in the country, as indicated by Deloitte's serving as auditor for the Petroleum Fund as part of the Timor-Leste EITI. As for safeguards of professional independence, these are not comprehensive. Audits of companies that do not make public offerings of shares or debentures are done by their audit boards. As noted above, these boards must exclude by law the company secretary, directors, employees or agents, and any relative of these to the third degree, as well as partners and shareholders (Law on Commercial Companies, art.67). The board is to be elected or re-elected for a one-year term at the general meeting, and may be removed for cause (after having the opportunity to heard at the meeting) (art.68). Otherwise, company audits are to be done by independent auditors with no relationship to the audit board or its members. The same applies to audits of banks, except that those under a size threshold are permitted to have these done by the internal auditor. In addition, the tasks of bank auditors include regular accounting functions (Banking Law, arts.32-33). As discussed above, this approach is understandable as a proportionate response to scarce capacity in Timor-Leste, but it does not comport with good international practice.

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) and 2): No known standards or codes.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	Per Companies and Banking Laws: 1) Commercial companies use audit board, or appoint external auditor if shares/debt held by public. Banks appoint external auditors or use internal auditors if under size threshold. 2) Audit and non-audit tasks are not kept separate. 3) No provision. 4) Commercial companies: restrictions on audit committee members and external auditor relationships to audit board. 5) No restriction.
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) through 4): No provision.

D. Enforcement

Timor-Leste is still building a legal system from disparate elements including enactments by the UN and prior regimes. This is a major task, especially for a poor country that has been independent for little more than a decade. Thus, not surprisingly, the enforcement provisions related to financial reporting and audit standards are as incomplete as other parts of the system.

The Companies Law (art.88) stipulates a procedure to be used when companies have not presented annual accounts to the shareholders within three months of the end of the financial year. In this situation, a shareholder may petition a court to set a deadline within 60 days for the company to present its accounts. If this deadline is not met, the court may terminate the appointment of one or more company directors and order a judicial examination, appointing a judicial administrator with the task of preparing the annual accounts and the management report for presentation to the shareholders. Certain other provisions of the law refer to criminal offenses, for which sanctions are not stated in the Companies Law but presumably in the penal code.

The Banking Law (arts.36-37) empowers the Central Bank to take action against a bank or any of its managers or principal shareholders guilty of violating the Law, a Central Bank regulation, or other conditions, limitations, or agreements. A range of sanctions is available. These include written warnings, a written enforcement agreement stipulating remedial actions, written orders to cease and desist from infractions and take remedial action, fines of USD 500 to USD 5,000 per day for continuing violations, suspension or dismissal of directors, and revoking the bank’s license and appointing a receiver. Another list of sanctions applies to individual managers, employees, or owners of a bank. The persons sanctioned are those who willfully violate the Law or any Central Bank instruction and thereby cause material loss to the bank or financial gain to the individual, or who persist in willful violations despite a written warning by the Central Bank. The sanctions here include ordering the person’s dismissal from the bank, prohibiting the person from participating in the bank’s affairs including the voting of shares, and ordering the person to dispose of ownership interests in the bank or to reimburse losses caused to the bank.

International standard	Compliance by member country
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2): Accounting and audit rules are evolving and not sufficiently comprehensive to restrain corruption effectively. It is not clear how fully the rules are used for this purpose.
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Sanctions include judicial orders and administration of accounts under Companies Law, and fines up to USD 5,000 per day, dismissal of officers, and closure of banks under Banking Law. 2) Penalties apply to companies and individuals 3) Judicial and regulatory procedures for enforcement appear effective in principle, but impact in practice not clear.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) through 3): As above.[22]

5. Conclusion and recommendations

A. General efforts to prevent corruption involving the private sector

Timor-Leste has several ongoing activities in this sphere. The Ombudsman provides a channel for complaints about maladministration by individuals and businesses. The CAC is planning to set up an equivalent mechanism as required by its statute. The Commission is also tasked with public outreach and education on corruption prevention, and it has authority to provide witness protection and conduct stings. Civic groups are active in this area, and the chamber of commerce represents business interests in policymaking. Where these actors come together is in the Timor-Leste EITI, in which government, the private sector, and NGOs work together to ensure transparency and accountability in the flow of oil sector funds and the administration of the Petroleum Fund, which is central to government revenues.

Recommendations

1) Build on the EITI experience to establish integrity pacts in other sectors such as infrastructure contracting, and to engage government, business, and civic sectors in creating a code of corporate governance for Timor-Leste.
2) Expedite the establishment of the corruption complaint channel of CAC, and enable the Commission to provide sentence mitigation and other incentives for self-reporting of corruption offenses.

B. Internal controls

Although banking legislation refers to internal audit, there is no explicit requirement for banks or other companies to establish this function. Audit boards are required by the Companies Law, and audit committees by the Banking Law, although these requirements apply only to entities that meet a size threshold. The audit boards and committees are elected by the shareholders, supervise accounting and audit, ensure legal compliance, and perform other functions. There is no explicit anti-corruption function. Internal control systems are not required for companies generally, though they are subject to restrictions on related-party transactions. Banks and SOEs must establish, respectively, risk management committees and monitoring boards to address legal compliance – and in the case of banks, the various market and operational risks. No controls are stipulated on corruption risks *per se.* Money-laundering legislation does require banks and certain other companies to set up internal audit and control for purposes of compliance with that law.

Recommendations

1) Phase in explicit internal audit requirements for large and public companies, as well as banks. Support development of an internal audit profession and standards.
2) Phase in internal control requirements for private sector companies, especially large and public companies, along with banks. Include in the requirements a prevention of corruption mandate, management of corruption risks, and standards on “tone at the top” and company-wide support.
3) Incorporate explicit corruption prevention and risk reduction requirements into the legal provisions on audit and risk management committees, and audit and monitoring boards.

C. Integrity of financial statements

The Companies and Banking Laws require the keeping of records in specified places, in a manner that provides an accurate description of the entity’s business affairs. However, the range of manipulative practices that enable the concealment of corruption are not prohibited, nor is any retention period stated apart from that given (five years) in the anti-money laundering statute. SOEs, along with commercial companies and banks meeting defined thresholds, must prepare financial reports. Company reports must also address performance and management issues, while financial institution reports must be prepared in accordance with general or international reporting standards, signed by the directors, and published. Commercial company audits are carried out by the audit board, except in the case of companies offering shares and debt to the public. The latter firms must have independent external audits, and this requirement applies as well to banks above a size threshold. Below the threshold, banks may be audited by their internal auditors. Audit standards are not stated, except for banks and companies participating in the EITI, for which compliance with ISA is required. Auditors of commercial companies have a general legal duty to report crimes to the authorities. Financial institution auditors are required by law to report to the Central Bank any fraud discovered, along with any illegality likely to result in material loss. Also, the money-laundering statute requires the reporting of suspected offenses. No explicit safe harbor is established to protect the auditor from liability for such reports. Timor-Leste appears to have no formally organized accounting and auditing profession, thus no professional or ethical standards beyond the legal standards on auditor appointments and the norms applicable in the countries where these professionals train and qualify. Enforcement provisions, including judicial proceedings, appear effective in principle. But they are incomplete and their effects in practice are not clear.

Recommendations

1) Adopt a minimum retention period of at least seven years for accounting records. Also prohibit the full range of manipulative practices used to conceal corruption, such as falsification and off-the-books dealings.
2) Phase in adoption of IFRS for required financial reports. Do the same for ISA for all required audits.
3) Separate independent external audit from internal audit and the activities of corporate audit bodies. Require all large and public companies, and all banks and large non-bank institutions, to have annual external audits done.
4) Adopt an explicit duty for auditors to report fraud and corruption to the authorities. Include a safe harbor provision to protect reporting auditors from liability.
5) Support the development of a Timorese accounting and auditing profession, with an independent oversight body and professional and ethical standards. Structures and norms could in the near term be borrowed from best-practice countries.
6) Move ahead with the completion and rationalization of the laws of Timor-Leste in this area, paying particular attention to the enforcement provisions and sanctions.

Timor-Leste laws, regulations, policy documents referenced:

Decree-Law No. /2003 On Public Companies, http://cac.tl/wp-content/uploads/2011/11/Law-8-2009-CAC1.pdf

Governing Board Resolution No 11/2010 Concerning the approval of Public Instruction No.06/2010 On the Licensing and Supervision of Other Deposit Taking Institutions (ODTIs), art.24, http://www.bancocentral.tl/Download/Instructions/Pub_Inst_6_2010_en.pdf.

Instruction CPO/B-2000/9 Audits, Publication of Auditor's Opinion and Annual Report, http://www.bancocentral.tl/Download/Regulations/CPO-B-2000-9.pdf.

Instruction CPO/B-2000/8 Bank Reporting and Publication of Balance Sheet, http://www.bancocentral.tl/Download/Regulations/CPO-B-2000-8.pdf.

Law on the Anti-Corruption Commission, No. 8/2009, arts.5, 22-23, http://cac.tl/wp-content/uploads/2011/11/Law-8-2009-CAC1.pdf

Law on Commercial Companies, No. 4/2004, http://www.jornal.gov.tl/lawsTL/RDTL-Law/index-e.htm.

Law no. 17/2011 on Legal Regime Covering the Prevention of and Combat Against Money Laundering and Financing of Terrorism,

http://www.jornal.gov.tl/lawsTL/RDTL-Law/RDTL-Laws/Law%2017-2011%20.pdf.
UNTAET Regulation No.2000/8 On Bank Licensing and Supervision, http://www.bancocentral.tl/Download/Regulations/Reg2000-08.pdf.

NOTES

[1] *Sources*, unless otherwise designated*:* http://www.dfat.gov.au/geo/timor-leste/timor-leste-brief.html, http://export.gov/Indonesia/static/CCG%20Timor%20Leste%202013%20_Latest_eg_id_067604.pdf.

[2] Government points out that this situation is changing with the recent entrance of the Indonesian Telekom to compete with Timor Telecom, and two major public investments (over USD 400 million) in the last two years in the power sector.

[3] *Doing Business in the g7+ 2013*, http://doingbusiness.org/~/media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB14-Chapters/DB14-Mini-Report.pdf. This report compares business regulations in economies of the g7+ group. The latter is a country-owned and country-led global mechanism established in April 2010 to monitor, report and draw attention to the unique challenges faced by fragile states. See also: http://doingbusiness.org/~/media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB14-Full-Report.pdf.

[4] Government also points out that, in 2014, a proposal to include all elected and other important public officials under the declaration of assets and conflict of interest rules has been endorsed and sent to the Parliament.

[5] http://www.state.gov/e/eb/rls/othr/ics/2012/191249.htm.

[6] http://www.track.unodc.org/LegalLibrary/pages/LegalResources.aspx?country=Timor%20Leste.

[7] Law on the Anti-Corruption Commission, No. 8/2009, arts.5, 22-23, http://cac.tl/wp-content/uploads/2011/11/Law-8-2009-CAC1.pdf.

[8] http://www.iade.gov.tl/en/business-man/chamber-of-commerce/; http://www.easttimorlawandjusticebulletin.com/.

[9] Coffey International Development and IPAN (2010), *Validation of the Extractive Industries Transparency Initiative (EITI) in Timor-Leste*, http://lutahamutuk.org/yahoo_site_admin1/assets/docs/IDEVREAN09001TP_fr.9463044.pdf.

[10] The sources of all standards are provided in footnotes to the tables presented in the section of the Review entitled *International Standards for Country Reports.*

[11] Government points out that the study and development of a “Clean Company” statute is ongoing. That legislation would require large non-financial corporations to submit periodic reports to the Central Bank of Timor-Leste, confirming that the companies are not involved in drug trafficking, money laundering, or other crimes.

[12] The Law on Commercial Companies, No. 4/2004, http://www.jornal.gov.tl/lawsTL/RDTL-Law/index-e.htm.

[13] The audit board and the audit committee mentioned below in the banking context are sometimes referred to as a “fiscal council” or “control board.”

[14] UNTAET Regulation No.2000/8 *On Bank Licensing and Supervision*, http://www.bancocentral.tl/Download/Regulations/Reg2000-08.pdf.

[15] Instruction CPO/B-2000/9 Audits, Publication of Auditor’s Opinion and Annual Report, http://www.bancocentral.tl/Download/Regulations/CPO-B-2000-9.pdf.

[16] Government comments.

[17] Decree-Law No. /2003 On Public Companies, http://cac.tl/wp-content/uploads/2011/11/Law-8-2009-CAC1.pdf.

[18] Law no. 17/2011 on Legal Regime Covering the Prevention of and Combat Against Money Laundering and Financing of Terrorism, http://www.jornal.gov.tl/lawsTL/RDTL-Law/RDTL-Laws/Law%2017-2011%20.pdf.

[19] Government also reports an ongoing initiative to adopt a bill on transparency in procurement, which would require all companies bidding on state contracts to register their assets.

[20] Instruction CPO/B-2000/8 *Bank Reporting and Publication of Balance Sheet*, http://www.bancocentral.tl/Download/Regulations/CPO-B-2000-8.pdf.

[21] Governing Board Resolution No 11/2010 *Concerning the approval of Public Instruction No. 06/2010 On the Licensing and Supervision of Other Deposit Taking Institutions (ODTIs),* art.24, http://www.bancocentral.tl/Download/Instructions/Pub_Inst_6_2010_en.pdf.

[22] Government points out that Law No. 17/2011 provides penalties as well as enforcement mechanisms, such as the Financial Intelligence Unit, for the anti-money laundering rules. It is important to note that these are not accounting or audit rules, but the sanctions do reinforce the requirement to report truthfully on relevant transactions.

Thailand

1. Introduction[1]

Thailand continues on its dynamic development path, attracting investment and sustaining growth despite turbulent politics and other difficulties. In 2011, the World Bank upgraded Thailand's status from a lower-middle-income to an upper-middle-income economy. Socioeconomic development continues to make progress, but large numbers of Thais still suffer from poverty and social exclusion – most acutely among minorities in the North and far South, and in the populous Northeast. The country faced major setbacks in 2011, with severe supply chain disruptions due to the earthquake and tsunami in Japan, combined with flooding in Thailand, reducing GDP growth from nearly 8% to 0.1%. But consumption and investment rebounded in 2012.The country also continues to have a large informal sector, accounting for over 60% of the workforce and about 50% of GDP – and essentially untaxed.

Thailand is generally considered business-friendly, with investor protections, incentives for foreign companies, and improving infrastructure and human resources. Still, the burdens of government regulation and inefficient bureaucracy are competitive disadvantages for Thailand, according to the World Economic Forum. Responding to the banking and competition issues that helped produce the 1997 crisis, Thailand has sought to reduce price fixing and monopolies and to enhance banking transparency. Competition policy has proved to be relatively ineffective due to the numerous exemptions accorded to state-owned companies and influential businesses. On the other hand, private sector banks are stable and well-capitalized, with the majority of them listed on the Stock Exchange of Thailand (SET), ensuring at least a minimum of transparency for these institutions. The stock market itself has grown rapidly, becoming a major regional center, but also showing volatility.

Thailand's political climate has also been volatile, marked by conflicts, occasionally violent, over corruption and governmental legitimacy. Controversy continues to revolve around the legacy of exiled former Prime Minister Thaksin, who has been subject to asset seizures and a continuing arrest warrant for alleged abuse of office. Corruption is at the center of political contention, with government and opposition trading charges, protest marches and denunciations, and some 28 private organizations forming a Coalition Against Corruption.

In Thailand, corruption is seen as occurring mostly at the intersection between business and government, where illicit payments are widespread."Money politics," or the flow of funds into politics, has fostered a high degree of interconnectedness among politicians, civil servants, and businesspeople at all levels. According to the US Department of State, bribes are treated as fees or commissions, and considered a routine part of doing business in Thailand. In addition, board memberships in Thai corporations are still characterized by an emphasis on personal connections over professional competence. Despite civil servants being legally barred from serving as directors of private sector companies, high-ranking bureaucrats are commonly found on the boards of Thai companies.

Bribery is reported to be concentrated in a few government sectors including procurement, land, tax and customs, transport, and police. Public procurement is an area where the risk of corruption is especially pronounced. Estimates of losses from corruption in government contracting have ranged up to 30% of the government procurement budget. Most infrastructure projects are reported to be hampered by corruption, and fraud in land development is also seen as rampant. In the tax area, Freedom House has estimated annual losses to tax evasion at about USD 3 billion, equivalent to one-fifth of Thailand's potential tax revenues. Cases of procurement, tax, and land-related corruption are often reported in the press and are being pursued in ongoing investigations. According to the World Economic Forum, international companies view the corruption, government instability, and policy volatility occurring in Thailand as posing obstacles to doing business there.

2. General efforts to prevent corruption involving the private sector[2]

Active and passive bribery, attempted corruption, extortion, and serving as an intermediary between two parties exchanging bribes and services, are all punishable by heavy sentences including capital punishment under the Penal Code Act, B.E. 2499 and 2502. The Code does not appear to cover bribery of foreign officials or business-to-business corruption. While Thailand's legal framework for combating corruption has been in place since the late 1990s, enforcement of anti-corruption laws has generally remained weak. Petty corruption is dealt with regularly and is cited to demonstrate that the government is taking its anti-corruption role seriously.

The National Anti-Corruption Commission (NACC) is the primary body responsible for combating and preventing public corruption in Thailand. The NACC has the power to investigate cases involving politicians and state officials. According to the Organic Act on Counter Corruption B.E. 2542 (1999), amended (No. 2) B.E. 2554 (2011), the NACC's main duties are:

- to inquire into facts and summarize cases in order to prosecute corrupt officials;
- to verify the accuracy and actual existence of, as well as changes in, assets and liabilities of persons holding a political position and state officials; and
- to take action with a view to preventing corruption and foster attitudes and values of integrity and honesty.[3]

Political instability in Thailand has not affected the NACC, and the prosecution of possibly corrupt officeholders is reported to have become more rigorous. According to the US Department of State 2012, the NACC received 2,288 cases and completed 3,642 cases, with 212 cases requiring further action.[4]

Thailand is attempting to encourage public-private cooperation to combat corruption. The NACC played a major role in developing the National Anti-Corruption Strategy, which, among other things, calls for mobilization of private sector and civil society cooperation. Further, the Office of the Ombudsman investigates complaints about public officials' negligence in performing their duties according to the law, and in doing so has reached out to civil society in a way that has been publicly appreciated by the NGO community. Thailand has witness protection and whistleblower provisions in the Witness Protection Act B.E. 2546 (2003), while the NACC organic legislation and regulation [5] provide measures for whistleblower and witness protection in corruption investigations. Under the law on money laundering, [6] predicate offenses include misappropriation, fraud, and corruption by directors or officers of financial institutions or entities engaged in securities business. The law therefore requires such organizations to report suspicious transactions to the Anti-Money Laundering Office (AMLO). The Office of the Auditor General has a web portal (oaganticorruption.com) for reporting fraud and corruption affecting the public sector.

Thailand has legislative provisions designed to encourage self-reporting, effective responses to suspected corruption, and preventive measures by companies. Article 78 of the Penal Code stipulates that courts have discretion to mitigate the defendants' sentences if they provide information beneficial to the trial, including self-reporting on corruption. Further, the NACC Notification and the Office of Attorney General Regulation provide non-prosecution measures for defendants who give information of benefit to the NACC or Attorney General investigations.[7]

State agencies reach out to the private sector to increase awareness of anti-corruption and financial transparency issues. NACC has a Public Procurement Center, which has organized seminars on integrity in government contracting. Some of these have provided guidance to the private sector, for example a seminar for companies contracting with state agencies, concerning the preparation and submission of project accounts. These income and expenditure accounts are required by the anti-corruption law.[8] The Securities Exchange Commission (SEC) holds seminars for public limited companies (PLCs) and professionals on such topics as financial disclosure procedures. The SEC has encouraged securities issuers, banks, and securities companies to engage in the Collective Action Coalition Program, a scheme to raise awareness of the need to adopt corporate policies against corruption.[9]

In November 2010, the NACC kicked off an anti-corruption awareness campaign that coincided with the hosting of the 14th International Anti-Corruption Conference in Bangkok. The conference, described as a milestone in Thailand´s effort to combat corruption, resulted in its ratification of the UN Convention against Corruption and raised public awareness. The Anti-Corruption Organization of Thailand (ACT) signed an agreement with NACC to include integrity pacts in procurement processes. Further, as will be discussed below, SET in 2006 developed the *Principles of Good Corporate Governance For Listed Companies* in an effort to support improved ethics rules, internal controls, and governance structure within the corporate sector. The Securities and Exchange Commission (SEC) cooperates with industry organizations to recognize good corporate governance performers through awards competitions and other means, and thereby to encourage other listed companies to adopt best practice principles into their business operations.[10]

Government agencies and private sector associations are also involved in benchmarking corporate governance practices. The Ministry of Commerce’s Department of Business Development (DBD) has developed programs to encourage good corporate governance in private entities and to enhance services provided by accounting firms. These include programs on training and information-sharing, as well as a “Good Governance Company Award” to incentivize good practice. Also, the SEC, together with the Thaipat Institute, are reported to be preparing an Anti-Corruption Progress Indicator and CSR (Corporate Social Responsibility)Progress Indicator for listed companies. These indicators will serve as tools to encourage transparency of and social benefits from listed companies.

The Institute of Directors (IOD) has continuously assessed corporate governance practices of listed companies since 2001. The overall survey results are published in the *Corporate Governance Report of Thai Listed Companies* (CGR). The CGR project has thus enabled Thai PLCs to advance their corporate governance, including anti-corruption practices, toward the international standards. Leading Thai institutional Investors collaborate with their members to encourage good corporate governance including CSR and anti-corruption in Thai PLCs. Recently, they launched proxy voting guidelines to support these goals.[11]

The Private Sector Collective Action Coalition Against Corruption (CAC) is designed to foster cooperation among listed companies, private limited companies, and others to develop anti-corruption guidelines and transparency standards for business operations, and to set an example of integrity in corporate governance. The project is managed by private sector organizations including chambers of commerce and sector-specific associations, along with IOD. Companies join the CAC by signing a declaration of commitment to comply with the agreed standards, and they can move to a second level of participation by becoming certified as fully compliant with the standards. The standards require adoption of anti-corruption policies and their implementation through risk assessments and prevention measures; disclosure and audit of these policies and practices; and joint action with other companies in the same sector or group in order to advance anti-corruption safeguards in the private sector. Certification involves a self-assessment by the member and an audit of the assessment, along with review by a third party. Over 300 companies have joined the CAC, of whom about 50 have been certified.[12]

International standard[13]	Compliance by member country
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	Efforts underway by NACC and Ombudsman to promote public-private cooperation against corruption.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) NACC, Ombudsman, OAG, and AMLO provide channels for complaints and reporting. Whistle blower protections in place. 2) Thailand has legislation that encourages self-reporting, effective responses to suspected corruption, and preventive measures by companies.
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) NACC and Ombudsman reach out to civil society to raise awareness and strengthen prevention. National Anti-Corruption Strategy calls for mobilization of private sector and NGOs to deter corruption. 2) and 3): SET Principles of Good Corporate Governance provide standards for listed companies, and Federation of Accounting Professions adopted ethics code for accounting and audit professionals. DBD and IOD benchmark corporate governance practices.
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	SEC and DBD awards and related activities provide incentives for integrity. CAC has mobilized over 300 major businesses in an integrity pact dealing with anti-corruption standards and transparency.

3. Internal controls

Internal company governance is addressed – for listed companies – in SET's Principles of Good Corporate Governance.[14]The Principles are applied on a "comply or explain" basis, and are aimed at bringing corporate governance up to international standards. Companies are advised to disclose not only whether they comply but also the manner or extent of compliance, including any adaptations that have been made to the Principles, and to explain in detail their reasons for adaptation or non-compliance. Last, the companies should disclose their practices by other channels to reach as many stakeholders, investors, and other interest parties as possible – including by the company website.

A. Internal audit

Thailand has a chapter of the Institute of Internal Auditors (IIA) to support the practice of internal auditing and ensure that it meets international professional standards. The International Standards for the Professional Practice of Internal Auditing (International Professional Practices Framework or IPPF) have been translated by IIA-Thailand.[15]

Banks are required to comply with the Bank of Thailand's (BOT) guidelines on internal auditing, which require an internal audit function to review and validate the internal control and risk management system. Other companies generally are not required to establish an internal audit function, nor is this mandated in the securities laws. However, the regulatory agencies use their authority to ensure proper internal governance.

The SEC and the SET require listed companies and those issuing shares to the public to have an internal audit team to monitor foreseeable risks.[16]The SEC imposes standards consistent with the IPPF. These standards require the internal auditor to develop risk-based audit planning, to evaluate risk exposure relating to the organization's operations, and to establish management control systems. Under the audit committee guideline issued by the SEC for PLCs, internal audit quality assurance assessment by independent third party should be held every 5 years. The assessment of internal audit procedures for reviewing financial statements and safeguarding of assets should be in conformity with the IPPF. The SEC disclosure manual states that the internal auditor reports functionally to the board or audit committee. Further, an SET rule[17]requires reviews of the legality of transactions and the safeguards against fraud, conflict of interest, bribery and other forms of corruption – but places this directly under the responsibility of the audit committee.

The Bank of Thailand requires licensed financial institutions to carry out internal audit. The internal audit unit must review accounting records and internal controls, and report to the audit committee and the board of directors. BOT requires institutions' internal auditors to review the credibility and accuracy of financial data, including the effectiveness of the tools used for assessing, measuring, classifying, and reporting the data. The chief of internal audit must create risk-oriented audit plans by taking into account all risks and controls related to the departments/units to be audited. The internal auditors are required to review transactions to ensure that they comply with regulations. Moreover, the internal auditors are required to review the internal control systems by focusing on the prevention and detection of frauds, errors, omissions, and other irregularities. If an institution has effective risk assessment systems, the chief of internal audit may exercise discretion in determining the frequency of internal audits for units not considered to be significant.[18]

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	Listed and issuing companies are required to have internal audit, as well as licensed financial institutions such as commercial banks.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect "illegal acts" in the books and records of companies, including bribery and other forms of corruption.	1) and 2): Thailand has a chapter of IIA, which supports internal audit practice in line with international standards including duty to prevent and detect illegal acts.
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	Per questionnaire responses: 1) and 2): SEC, SET, and BOT requirements cover basic and risk-based internal audit. 3) SEC, SET, and BOT require such review. 4) Required by SEC and BOT.

B. Audit committee

There appears to be no general requirement for companies to establish audit committees, supervisory boards, or the equivalent. However, listed companies are required to establish audit committees, according to the SET Principles of Good Corporate Governance (ch.V) and the Listing Rules. The Principles (applied on a "comply or explain" basis) further advise that the majority of the committee members should be independent directors, that the chairman of the committee should be an independent director, and that the chairman of the board of directors should not be either a chairman or a member of the audit committee.[19]

As for the functions of the committee, the SEC and SET require them to perform the following duties at least annually: review financial statements for accuracy; review compliance with laws, rules and regulations; and consider any connected transactions to ensure compliance with rules and regulations and to safeguard the interests of the company. In addition, the board must assign a person or a department to independently audit and report on the internal control system, including financial, compliance, and policy controls, and must review the system at least annually. The board should have clear procedures on whistleblowing and provide a channel, via independent directors or the audit committee, to arrange an investigation and report findings to the board.[20] BOT and the insurance regulator (OIC) have similar requirements for financial institutions and insurers, respectively.[21]

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	Per SET Corporate Governance Principles and Listing Rules: 1) Listed companies to establish audit committees. 2) Chair and members to be independent directors, and board chairman not to be a member.
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers, employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	1) and 2): Stipulated by SET, SEC, BOT, and OIC for listed companies, financial institutions, insurers. 3) through 5): Compliance and whistle-blowing are covered in the above instruments, but no explicit reference to corruption.

C. Internal control and compliance systems

Again, no general rule seems to be applied to all companies, but listed companies and financial institutions do have obligations with respect to internal controls. The Principles of Good Corporate Governance (ch.V, art.3) provide that every listed company's board of directors should approve and institute a strategy and policy on risk, along with a written corporate governance policy that is to be reviewed (i.e. the policy itself and company compliance) annually. The board should also ensure that a written code of business conduct is in place so that all directors, executives, and employees understand the company's standards of business ethics.[22] Compliance with the code should be closely monitored by the board, which checks adherence to rules on conflicts of interest and financial and policy controls as discussed above. The board is to assign a person or a department to audit the system independently and report on it.

The board should establish a risk management policy covering all activities of the company, and assign management to implement the policy and report on it regularly. The effectiveness of risk management is to be reviewed at least annually, and whenever there is a change in risk level. The system should attend to early warning signs and unusual transactions.

The Principles (ch.V, art.2) emphasize disclosure. The board should provide a summary of the corporate governance policy and its implementation by several channels including the company's annual reports and web site. The company annual report should "contain a statement from the board of directors or audit committee on the adequacy of the company's internal controls and risk management systems."

As for financial institutions, the banking legislation[23] authorizes the Bank of Thailand to prescribe internal controls for an institution when it deems it necessary. Accordingly, BOT requires each institution's board of directors to take responsibility for overseeing internal governance and transparency. The board is required to establish an internal code of ethics and codes of conduct for directors, senior management, and employees. Senior management is responsible to provide staff guidance and training on internal controls and compliance.

Each financial institution must also maintain an efficient risk management system, which includes holding adequate capital against risk as well as transparency and safeguards for compliance with laws and regulations. Institutions must have an operational risk framework, approved by the board of directors, and review it periodically to reflect the current risk profile of the FIs and address new risks. Before hiring agents or outsourcing to other parties, FIs are required to conduct due diligence and assess the relevant risks. FIs must require the third party to comply with the FIs' internal guidelines together with laws, accounting standards and regulations governing the activity – and ensure compliance by conducting a periodic review. The institutions must also prepare an annual compliance report.[24]

A few other agencies apply similar requirements. The AMLO, which oversees financial institutions' compliance with the AML/CFT Law, requires financial institutions to verify customers' identity prior to any regulated transactions, and to conduct periodic due diligence on their customers. The institutions must have policies on acceptance of customers and the management of risks relating to money-laundering.[25] Further, insurers are required by law to have internal controls and risk management systems in place. The SEC has adopted rules obliging PLCs to report annually on their internal control systems, anti-corruption policies, and compliance.[26] In this regard, SEC has just launched a revised *Internal Control Self Assessment Questionnaire*, following the 2013 COSO[27] framework. The IOD's Self-Evaluation Tool for Countering Bribery, the most important part of certification process of the CAC project, provides step-by-step guidance for testing internal anti-corruption controls. The Tool is used in certifying CAC member companies.[28]

International standard	**Compliance by member country**
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees. 4) Risk-based approach: • Individualized assessment of risks to the enterprise, including corruption risks. • Regular monitoring and re-assessment of corruption risks.	Per Principles of Good Corporate Governance, applicable to listed companies, and BOT standards, applicable to banks: 1) Companies to disclose to the public their corporate governance policies, controls, and implementation. 2) Boards to adopt internal controls on financial and other matters, to be audited independently. (Also, IOD/ CAC require internal controls to prevent corruption.) 3) Code of business conduct to be adopted so that directors, executives, employees understand ethical requirements. 4) Board to establish risk management policy, with red flags and regular compliance review and re-assessment. (IOD/CAC: corruption risk management.)

Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements. 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations. 4) Require for third-party representatives, consultants, or agents: • Written contract, adherence to company ethics standards and anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	1) through 4): Per Principles of Good Corporate Governance (listed companies), board should adopt conflict of interest policies and procedures. Internal control system covers issues affecting financial reporting, which should include material issues of legal compliance. BOT standards (FIs) include similar requirements. IOD standards require prohibition of corruption, and guidelines on gifts and agents.
Enforcement, including sanctions for failure to comply.	SET and BOT may use their regulatory authority to ensure compliance.

4. Integrity of financial statements

A. Accounting

1. Financial records

Book-keeping is addressed in the Accounting Act,[29] which requires every registered partnership, limited company, public limited company, joint venture, and foreign company doing business in Thailand to keep accounts according to the Act (art.8). These businesses must keep their accounts and the documents related to them for five years (art.14), and this may be extended to seven years by order of the Director-General of the Department of Commercial Registration for any business or category of firms. The Director-General has authority, by gazette notification, to make rules specifying the accounts and documents to be kept, contents, duration, and related matters (art.7).[30] The business's bookkeeper must keep accounts in order to show results and financial status in accordance with the applicable accounting standards, and retain a correct and complete set of documents used for the entry of accounts (arts.12, 20).A company in liquidation must turn its accounts and documents over to a Department inspector, who is to keep them for five years (art.17).

Failure to comply with these requirements is subject to fines. Damage, concealment, and false statements and entries are subject to fines and imprisonment – applicable not only to individuals responsible but also to companies and their managing directors or representatives (Accounting Act, arts.31, 33, 38-40). In addition, the Public Limited Company Act[31] (art.94) imposes liability for damages to shareholders and third parties on any director who submits a document to the Registrar with false information, including particulars that do not correspond to the company accounts, registers, or documents. Further, the Financial Institutions Business Act (section 92) prohibits financial institutions from making false or misleading financial reports.
The Securities and Exchange Act (B.E. 2535) provides rules similar to those above, including a five-year retention period and the duty to maintain a system for safekeeping of documents and evidence in relation to information disclosure, which may be electronic. Persons are liable to penalties for alteration, destruction, falsification, or inaccurate keeping, if done or permitted in order to deceive or harm the company, shareholders, or others (arts. 312 and 315).[32]

International standard	Compliance by member country
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	Per Accounting Act, all businesses to keep accounts and related documents for 5 years, in some cases 7 years.
Prohibitions (UNCAC 12(3), OECD Convention 8(1)), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	1) through 6): Per Accounting Act, false entries, damage, concealment are subject to fines and imprisonment. Per PLC Act: submitting false information to Registrar, including details not consistent with accounts or documents, subject to liability for damages. Securities and Exchange Act also prohibits falsification, destruction, keeping of inaccurate accounts with attempt to deceive or harm.

2. Financial reporting requirements

The Accounting Act (art.11) provides that all businesses incorporated in Thailand must prepare annual financial statements and submit them to the accounts office of the Department of Commercial Registration. The financial statement must contain particulars determined by the Director-General. Failure to comply is subject to fines (art.31). The Public Limited Company (PLC) Act requires such companies to prepare a balance sheet and a profit and loss account annually, have them audited, and submit them to the shareholders with the annual report of the directors for approval (arts.109-114). The statements are to include any particulars required by ministerial regulations. The Securities and Exchange Act (sec.56) requires an issuing company to prepare financial statements and annual reports, and confers the power on the Capital Market Supervisory Board power to determine specific details of the information to be disclosed by such company.[33]

In addition, the Financial Institution Business Act (FIBA) requires banking institutions to prepare annual and semi-annual financial statements in accordance with approved accounting standards. Audited financials are to be submitted to the Bank of Thailand (BOT), published in the media, and posted in a public area of the institution according to BOT rules (arts.66-67). Slightly modified rules apply to branches of foreign commercial banks (art.68). The financial statement must be complete and correct. BOT may require an institution or its affiliates to submit additional information to clarify or complete any statement or document submitted. Also, BOT may appoint an auditor or expert to conduct a special examination, or have any of the bank's directors or personnel – including its auditors – testify or present additional information as it deems necessary (art.71).

Thai Financial Reporting Standards (TFRS) are translations of IFRS (bound version 2009). TFRS are issued by the Federation of Accounting Professions (FAP), the official accounting standards-setting body created under the accounting legislation. Standards are created by FAP's Standards-Setting Committee, which represents regulators, audit firms, industry, and others. The standards require approval from an independent body, the Oversight Board of Accounting Profession, and are published in the Government Gazette. Since 2011, the Federation has been replacing its older standards (Thai Accounting Standards) with TFRS. FAP plans to update the standards in line with IFRS (2012 version) and to add several IFRS that have not been included to date. In addition, FAP is adopting new simplified standards in accordance with IFRS for SMEs (2009). Adoption of IFRS has been somewhat delayed in Thailand due to the need to translate the standards into the Thai language, as well as a shortage of Committee personnel to review and process the large number of IASB pronouncements. FAP's stated policy is that IFRS will be adopted no later than two years from being issued by the IASB, and it holds seminars and other events to disseminate and receive feedback on the TFRS.[34]

Financial statements in accordance with TFRS are required for companies under the PLC Act, entities whose equity or debt instruments are traded in a public market (domestic, foreign, overt-the-counter) or that are seeking regulatory approval to issue securities in a public market, and fiduciary institutions holding assets for investors such as mutual funds and financial institutions. These financial statements are required to be prepared on a consolidated basis. Any non-public company which is a subsidiary of a public company must apply full TFRS, as its parent is required to do. The Stock Exchange permits listed companies to apply those IFRS that have not yet been adopted in addition to those that have been adopted (with added disclosures). Financial institutions and insurance companies must apply TFRS whether they are Publicly Accountable Entities (PAEs) or not. Other companies, designated Non-Publicly Accountable Entities (NPAEs), have the option of applying Thai GAAP or the Thai version of IFRS for SMEs, i.e. TFRS for Non-Publicly Accountable Entities (NPAEs).[35]

International standard	Compliance by member country
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) PLCs, listed companies, financial and fiduciary institutions required to issue financial statements according to TFRS, which are in process of full convergence with IFRS. 2) Simplified standards to be used by non-public entities: TFRS for NPAEs. 3) Disclosure of these liabilities for entities under common control of parent company required by TAS 27, which is being (or has been) replaced by a TFRS equivalent based on IFRS 10.[36]
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) IAS 37, incorporated as TAS 37 (and TFRS equivalent) requires disclosure of such liabilities in certain cases, but normally not potential liability due to corrupt acts.[37] 2) False entries, concealment, and other manipulations of financial statements and records prohibited. No explicit mention of disguising illegality or corruption.

B. Audit

1. Auditing requirements

The financial statements of most businesses are required to be audited. Under the Accounting Act (art.11), audit and audit opinions are required for all financial statements except for those of registered partnerships with assets or capital below a threshold stated in ministerial regulations. The Public Limited Company Act (arts.120-127) requires annual appointment of auditors by the annual general meeting (AGM) of a public limited company (PLC). The auditor has authority to examine accounts, documents, and other evidence, and to interview directors, staff, and agents of the company as well as to demand materials from them. The auditor is to prepare a report and submit it to the AGM, and is also entitled to present audit materials and explanations to the shareholders. In turn, the shareholders of a PLC have the right to examine the financial statements (balance sheet and profit and loss account) and the report of the auditor. The company must submit its annual report to the Registrar, together with copies of the audited financial statements approved by the AGM and certified by an authorized officer of the company. PLCs are required to publish the audited balance sheet in a newspaper within a month of AGM approval.

In addition, FIBA (arts.67, 69) requires banking institutions to have their semi-annual and annual financial statements audited by an audit professional approved by BOT. The form of the statements is also prescribed by BOT, and the audited statements, as indicated above, are to be published and posted in a public area of the head office and each branch. The auditors are to provide an opinion on the financial statements in accordance with professional standards.

The Securities and Exchange Commission Act and regulations require all regulated entities and companies offering securities to the public to prepare quarterly financial statements. Semi-annual financial statements of all securities firms must be audited, while companies offering securities to the public must have their annual financial statements audited and their quarterly financial statements reviewed by an SEC-approved auditor. The directors and management of a company are legally responsible for the financial statements. The Commission is empowered to ask for additional information or explanations from the company and/or from the auditor, including the audit working papers. Violation of the Securities and Exchange Act and its regulations is a criminal offence for both the company and company management (World Bank 2008: 4[38]).

In the analysis of the World Bank (2008: 21)[39], there exists a two-tier audit system in Thailand comprised of (i) listed company audits, largely performed by major audit firms (including the international Big Four) and reviewed by the Securities and Exchange Commission, and (ii) other audits of uncertain quality. It may be appropriate to add to category (i) audits of financial institutions (many of them also listed), which require approval of BOT for both the auditor and the audit report, and therefore should meet reasonable quality standards.

The Auditing Standards Committee of FAP several years ago undertook a major program of issuing local auditing standards equivalent to all International Standards on Auditing and international auditing practice statements. FAP has direct responsibility for setting and promoting adoption and implementation of the ISA in Thailand. All of the revised ("clarity") International Standards on Auditing (ISA) are being (or have already been) translated as Thai Standards on Auditing (TSA) with no modifications, and were to be effective for audits of financial statements covering periods beginning in 2012 (FAP Action Plan, p. 9; World Bank 2008: 14).

Financial statements must be certified by a company's representative and a bookkeeper qualified under the Accounting Act. Management must sign a letter acknowledging responsibility for the fair presentation of the financial statements, confirming that the financial statements are free of material misstatements, and accepting the responsibility to provide reliable information, including all books of account and supporting documentation, to the auditor. The auditor provides an opinion. If an auditor finds any deficiencies in the internal control systems, she/he must issue a letter reporting the deficiencies to management and the audit committee. If deficiencies are pervasive and affect the trustworthiness of the financial statements, the auditor is required to state this in the audit report.[40]

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	Auditing controls appear robust in principle, but quality of audits of non-public firms was questioned in a World Bank (2008) analysis.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	1) and 2): All registered business entities except certain partnerships are required to perform audits. Public companies to publish audited financial statements. Banks and SEC-regulated firms must have auditors and audit reports approved.
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	Thailand has adopted ISA without amendment, including ISA 240 and 250.
Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks. 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	1) Auditor to provide an opinion on the financial statements in each case. Financial institutions: the bank of Thailand requires external auditors to assess, test and evaluate the internal control and internal audit process of the financial institutions. 2) Public companies: authorized company officer certifies audited, AGM-approved financial statements before submission to Registrar. SEC Act makes directors and management of company legally responsible for the financial statements. Auditors may demand any needed information, documents, and explanations. Failure to comply would incur liability.

2. Auditor reporting of improprieties

Individuals involved in corporate duties, including auditors, are under a general duty of confidentiality, according to the Public Limited Company Act (art.220). Information about the business that is “normally...kept confidential” can only be revealed as part of the person’s performance of duties or for an investigation or trial. Breach of the duty of confidentiality is subject to fines and imprisonment.

The PLC Act (arts.128-131) provides for special procedures in case of suspected impropriety, but this involves the appointment of inspectors rather than direct reporting by the auditor. Shareholders holding one-fifth of equity or comprising one-third of shareholders may apply in writing to the Registrar for appointment of an inspector. The Registrar may also appoint inspectors on its own initiative if it has reason to suspect that the company has defrauded creditors or cannot repay debts. Other grounds include the company having violated the PLC Act or made false statements in its disclosures, or the directors or staff having conducted business dishonestly or against the interests of the company or shareholders. Inspectors appointed under the above provisions have authority to enter the premises; demand documents, information, and statements from directors and staff; and inspect related companies as needed. The inspectors have official powers under the Penal Code to require cooperation. The inspector is to prepare an inspection report and opinion for the Registrar.

The Financial Institution Business Act (arts.69-70) imposes an explicit duty on an auditor to report improprieties. First, an auditor is to disclose any material misstatement by a financial institution in the audit report submitted to BOT. Failure to do so is subject to BOT’s withdrawal of the auditor’s approved status for banking audits. Second, where the auditor has reasonable ground to suspect fraud, the auditor is to notify BOT promptly and submit relevant evidence. Also, insurance legislation requires the audit committee of an insurance company to report any suspicious transactions or activities of the company to Office of Insurance Commission.

Public and listed companies, and their auditors, are required under the Securities and Exchange Act (sec. 89/25) to report fraud and illegal acts to their audit committees and to the SEC. Where an auditor discovers evidence that a director, manager, or any person responsible for the operation of the company has committed an offense under certain sections of the Act,[41] the auditor must inform the audit committee, and the latter must report the results of its preliminary inspection to the SEC Office and the auditor within thirty days. If the audit committee fails to comply, the auditor is then responsible for reporting the matter to the SEC.The Securities and Exchange Act does not state a materiality threshold defining the auditor's duty to report possible corruption, but leaves this to the auditor's professional judgment.

Audit and professional standards confirm the auditor's duty to report externally, also providing a safe harbor against liability. According to TSA 260, matters communicated internally include how the auditor proposes to address the significant risks of material misstatement, whether due to fraud or error. TSA 240 states that when the auditor has obtained evidence that fraud exists or may exist, the matter should be brought to the attention of management as soon as practicable. This is so even if the matter might be considered inconsequential. The FAP Code of Ethics for Professional Accountants (2012) further states that there are certain circumstances where professional accountants may be required to disclose confidential information, such as where it is permitted by law or is authorized by the client or the employer. FAP regulations state that the disclosure of client information to authorities in accordance with law does not count as a breach of confidentiality.[42]

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	Auditors have a duty, per banking and securities legislation, and TSA 240 and 260, to report improprieties to management or the board.
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").	1) Per FIBA, auditor to note material misstatements in audit report to BOT, and to report promptly any reasonable suspicion of fraud. Per Securities Act, auditor or audit committee to report illegalities to the SEC. Per PLC Act, Registrar or shareholders may require appointment of inspectors to investigate suspected fraud, dishonesty, etc. 2) Per PLC Act, duty of confidentiality, backed by sanctions, includes exceptions such as trial and investigation. Accounting profession rules provide safe harbor.

C. Professional standards and independence

Accounting and auditing practice in Thailand is governed by the Accounting Professions Act,[43] which authorizes FAP as an institution to promote and develop the accountancy profession (art. 6). The Federation has authority to promote education and research, support and represent its members, set accounting and auditing standards, register professionals as well as revoke licenses, certify courses and degrees, supervise the conduct of its members, and give advisory opinions on accounting and auditing matters (art.7). The Act requires all accounting, book-keeping, and audit professionals to be registered members of FAP. Auditors are required to be CPAs, and only they may deliver audit opinions or certify audits (arts.10-11, 37, 44). Accountants and auditors are required to comply with the code of professional ethics, and auditors may not limit their liability in an audit contract or report (arts.46-48). FAP-administered penalties for ethical misconduct include written warnings, probation, suspension or prohibition from practice in the relevant area for three years, and revocation of license, registration, and/or FAP membership (art.49).

A CPA must have a degree in accounting from an approved university, satisfy practice requirements, and pass a set of seven examinations. Once qualified, FAP members must maintain their membership status by meeting continuing profession development requirements, which in 2013 were increased in line with international standards. The FAP Code of Ethics, applicable to all FAP members (hence all professional accountants in public practice and in business), is designed to be consistent with the IFAC-IESBA[44] Code (2010). However, FAP does not have legal authority to impose the full range of sanctions recommended by IESBA, but must pursue any civil or criminal sanctions through the courts. FAP plans to recruit more skilled staff to manage the disciplinary mechanism more rigorously. The Federation reports, for 2013, 12 allegations of misconduct under preliminary consideration, 20 cases in which investigations are being staffed, 13 cases under investigation, 13 investigations completed and orders issued, and 24 allegations of misconduct against practicing accountants on hold (FAP Action Plan, p.7, 12,17-18).

The Federation is a member organization rather than an independent agency. FAP has some 50,000 members, including about 7,000 CPAs, the majority from small firms. The World Bank (2008:21) expressed concern about FAP's capacity for oversight and enforcement in certain areas, and the Federation is attempting to strengthen its capabilities, as mentioned above.

Additional oversight is provided by the Ministry of Commerce's Department of Business Development (DBD), which has regulatory authority under the Accounting Act and the Accounting Professions Act (B.E. 2547 (2004)). DBD oversees accounting professionals and FAP. It supervises the preparation of financial statements, examining whether they conform to the

Accounting Act, and following up on submission of the financial statements. DBD also has the role of strengthening professional development by establishing training programs, holding seminars, and publishing articles.[45]

The Bank of Thailand approves and authorizes auditors of financial institutions. At present, the BOT-approved bank auditors belong mainly to the local affiliates of the major international accounting firm networks (the Auditor General audits state-owned banks and enterprises).

The Securities and Exchange Commission likewise approves and supervises auditors for regulated entities, and is responsible for monitoring and enforcing accounting and auditing standards in the regulated companies. Under the Securities and Exchange Act (art.107), the SEC has the power to withdraw its approval of an auditor who fails to adhere to the Code of Ethics, to carry out an audit, or to declare an opinion as provided by law. The SEC has authority to pursue administrative sanctions such as warning, probation, or suspension. Auditors working for firms in which the audit quality control system is defective are subject to sanction. According to the World Bank (2008: 7-16), SEC regulators themselves until recent years did not conduct reviews of audit firms' practices but relied largely on FAP's audit quality review and did not conduct on-site examination of audit practices or internal quality controls. According to more recent reports,[46]quality assurance reviews for SEC-approved auditors are carried out by the SEC Accounting Supervision Department. SEC inspectors follow a workflow and inspection manual reviewed and approved by the Quality Assurance Review Panel. The results of inspections of the audit quality control system are presented to the Panel for review and recommendations. Audit firms' quality improvement programs and actions are monitored and followed up by the SEC.

Safeguards of auditor independence are provided in legislation and the Code of Ethics. Under the PLC Act (art.121), an auditor may not be a director, employee, or person holding any position or having any duty in the company. The SEC requires auditors of companies under the SEC's supervision to hold certified public accountant (CPA) licenses and meet the criteria of auditors for public companies. Listed companies and banks must rotate their external auditors (those signing the opinions) after five consecutive years of service, unless the company is a State Enterprise and thus subject to audit by the Auditor General of Thailand. The Code of Ethics for the Accounting Profession imposes the same rotation requirement for external auditors as the IFAC Code of Ethics for Professional Accountants. If a former partner or member of an audit engagement team becomes a director, officer, or employee of the client, in a position to exert significant influence over the engagement, this is a threat to the audit team's independence under the Code of Ethics.[47]

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) Standards for licensing, practice, ethics prescribed by FAP under Accounting Professions Act. 2) FAP Code largely conforms to IFAC-IESBA Code.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	1) Auditors appointed by AGM. 2) No legal restriction, but FAP and IFAC Codes of Ethics discourage. 3) BOT and SEC approve audit firms and require rotation of lead auditors after 5 years. FAP Code follows IFAC. 4) Auditors of public companies may not hold any position or employment with audited entity. 5) Such employment discouraged by FAP and IFAC Codes.
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) and 2): Auditors must be CPAs and FAP members. CPA qualification based on fixed education, examination, practice, and continuing education requirements. 3) FAP, a professional membership body, supervises audit quality and practice. BOT and especially SEC provide additional oversight. 4) FAP may impose practice restrictions and license suspension or revocation, and SEC may use administrative penalties. Civil and criminal penalties available through the courts.

D. Enforcement

A range of enforcement provisions apply to companies, corporate directors and officers, and accounting and audit professionals. Under the Accounting Act (arts.31, 38-40), failure to prepare and submit audited financial statements or to keep proper accounting records is subject to fines up to THB 6,000 (USD 155[48]). Anyone who damages, destroys, or conceals company accounts or related documents is subject to graduated penalties that may include fines up to THB 40,000 (USD 1,230) and imprisonment for up to two years where the offense is committed by the official responsible for financial reporting. For making a false entry or omitting an entry in the accounts or financial statement, penalties include fines up to THB 60,000 (USD 1,840) and imprisonment up to three years. Where the offense is committed by a company, the managing director, partner, representative, or individual responsible for operations is liable for the penalty unless that person shows that she/he did not participate or give consent. DBD handles reports of persons who violate the Accounting Act, conducting investigations and referring criminal cases to the Economic Crime Suppression Division. As an example of the volume of such DBD cases, the numbers of investigations for the delayed issuance of financial statements in the period 2010-2012 are as follows: 15,244 in 2010; 16,718 in 2011; and 29,030 in 2012.

The PLC Act provides a substantial list of penalties. Directors are jointly liable for damages to shareholders and third parties for preparing false financial statements or including false information or details that do not correspond to accounting records in documents filed with the Registrar or provided to the shareholders (art.94). Companies and their directors who fail to comply with the Act’s provisions on keeping accounts, preparing and submitting annual financial reports, and related matters are subject to fines of up to THB 20,000 (USD 615) (arts. 191, 195, 205-207). A director or liquidator knowingly making a false statement or concealing facts in disclosures to shareholders related to the company’s financial condition, and anyone responsible for company business operations who damages the company by acquiring unlawful benefits to her/himself, is liable for fines up to THB 50,000 (USD 1,535)(arts.214-215). Anyone responsible for business operations who damages, destroys, or falsifies accounts or falsifies or omits material facts in accounts or documents of the company – or who permits such action – with the intention to defraud, is liable to imprisonment for up to five years and fines up to THB 1 million (USD 30,700) (art.216). Breach of confidentiality (art.220) is subject to imprisonment for up to one year and fines up to THB 2,000 (USD 61). Directors or representatives of firms who abet any of the above actions or fail to make reasonable efforts to prevent them are subject to the same penalties (arts.221-222).

The Securities and Exchange Act imposes criminal sanctions on company directors, executives, managers, and others (including auditors) who fail to comply with SEC regulations including those dealing with accounting, audit, and disclosure. The relevant sections (274, 287, 300, 312, 314 and 315) provide for fines up to THB 500,000 (USD 15,400) and imprisonment for up to 2 years for auditors who fail to comply with the rules for company audits, and lesser penalties for corporate officials in breach of the Act's auditing provisions. The companies themselves are subject to fines of up to THB 300,000 (USD 9,200) per day for improper financial reporting or auditing. For other offenses that may relate to accounting and audit (or other matters), executives or directors who fail to perform duties, so that the company is damaged or an individual obtains a benefit as a result of the failure, are subject to fines of at least THB 500,000 (USD 15,400) or the amount of damages (if greater) (section 281/2.4). If this offense is committed with dishonest intent, the minimum fine is THB 1 million (USD 30,700) or two times the damages (if greater), and imprisonment of up to five years may be imposed. Fines applicable to individuals may also be imposed on companies in many cases. For the period 2010 to 2012, the SEC inspected 26 audit firms and 91 auditors, and gave 16 notifications to external auditors for insufficient audit work, imposing two license suspensions and one revocation.

The Accounting Professions Act (arts.67-72) stipulates criminal penalties for those engaging in accounting and auditing practice without a license, especially certifying audit documents, and for professionals who practice while under suspension. Individuals guilty of these offenses are subject to fines up to THB 60,000 (USD 1,845) and imprisonment for up to three years. A firm that engages in audit practice without a valid registration is subject to fines up to THB 300,000 (USD 9,200), and smaller daily fines until the problem is rectified. For other offenses, where firms or corporations are found guilty, the authorized director, partner, or representative is subject to the same sanctions unless she/he proves the absence of knowledge or consent.

International standard	Compliance by member country
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2): Accounting and audit rules and sanctions are in some cases robust, in others not so. Studies suggest that enforcement has been uneven in practice, but that efforts are underway to strengthen it.
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Accounting, Accounting Professions, and PLC Acts provide modest fines for lapses in keeping accounts and financial reporting. Penalties for intentional falsehood, manipulation, and attempted fraud are stronger and include civil damages, fines up to USD 30,000 and imprisonment up to 5 years. 2) Companies are subject to fines, and responsible directors or officials are also liable to penalties for offenses by the company. 3) Effectiveness of enforcement is unclear.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Accounting, Accounting Professions, and PLC Acts provide modest fines for lapses in disclosure and audit. Penalties for unlicensed or improper audit practice are stronger and include imprisonment for up to 3 years. Directors' intentional falsehood or attempted fraud subject to fines up to USD 30,000 and imprisonment up to 5 years. 2) Companies and audit firms are subject to fines, and responsible directors or officials are also liable to penalties for offenses by the company or firm. 3) Effectiveness of enforcement is unclear.

5. Conclusion and recommendations

A. General efforts to prevent corruption involving the private sector

Thailand has made a number of serious anti-corruption commitments in an effort to respond to the governance weaknesses that contributed to its episodes of economic and political instability since the 1990s. The question remains whether these commitments are being carried out, especially with respect to private sector-related corruption. The criminal law penalizes active and passive corruption, but not corruption of foreign officials, and enforcement is reported to be uneven.[49] The NACC and Ombudsman provide focal points for complaints and reporting, and for outreach to civil society on combating corruption. Strengthening the law on citizen access to information in principle makes civic and private sector engagement more effective. The National Strategy in this area calls for government mobilization of the private sector for prevention of corruption, and this is reflected in such activities as the code of principles issued by SET and the awards competition run by the SEC to encourage best practices in corporate governance. The CAC initiative is bringing significant numbers of companies into an integrity pact.

Recommendations

1) Strengthen the laws against private sector bribery by criminalizing bribery of foreign public officials, establishing corporate liability, and facilitating enforcement by making incentives such as sentence mitigation more widely available to those who self-report.
2) Build on efforts by NACC, the Ombudsman, the SEC, and SET to create a coherent strategy and policy initiative on prevention and detection of private sector-related corruption.

B. Internal controls

Structures of internal control are not mandated by law but rather treated by key regulators as part of good practice to ensure corporate compliance. The main instrument here is the SET Principles of Good Corporate Governance, which provide voluntary guidelines for listed companies – guidelines that are backed up by the regulatory authority of the Stock Exchange along with the SEC. The Principles do not address corruption directly, nor do they apply as such to non-listed companies. Recently-issued Capital Market Supervisory Board rules do, however, call for policies and reporting on prevention of corruption.

The BOT requires financial institutions to establish an audit committee and specify the role to review financial reporting process and assess whether they have appropriate and effective internal control and internal audit system. Moreover, the BOT has the guideline on principles for the sound management of operational risk, where banks are required to have sound internal control to ensure the check-and-balance organizational structure and minimize the conflict of interests, as well as the guideline on internal auditing and compliance to ensure the effectiveness of integrity system. The internal control standards call for disclosure, codes of conduct, risk management systems, and controls on finance, accounting, and conflicts of interest.

Recommendations

1) Phase in the adoption of the Principles as mandatory legislation for all listed companies, along with the extension of the Principles as voluntary (and eventually binding) standards for other public companies. This means the phase-in of legal requirements for internal audit, audit committees, and internal control systems. For non-listed companies, this also requires a supervision capacity to be built up in the Company Registrar or elsewhere.
2) Spell out the provisions on internal audit, audit committee, and internal controls in more detail. Include procedures and reporting relationships for internal audit function, explicit terms of reference and oversight responsibilities for the audit committee, and provisions on risk management procedures and company-wide compliance for internal control. There should be guidelines on practices such as gift-giving and commission agents that can lead to corruption, and on monitoring and control of corruption risks.
3) The Accounting Federation should institute internal control standards for non-listed companies in order to enhance corporate governance in those enterprises.

C. Integrity of financial statements

Thailand has reasonably comprehensive rules on accounting, audit, and reporting. Documents are to be kept for five and in some cases seven years, while falsification in any books, documents, or statements is subject to significant penalties. Other kinds of account and document manipulation, however, do not appear to be addressed. All business organizations must produce annual financial statements, and nearly all of these must also be audited. Financial reporting and audit are treated, in effect, according to graduated requirements. Public and listed firms must report according to Thai Financial Reporting Standards, which are at an advanced stage of convergence with IFRS. Other firms use simpler standards designed for non-public interest entities. Banks and listed companies must have audits done by regulator-approved auditors and submit their audited financials to BOT and the SEC respectively. Audit standards are directly translated from the ISA. Semi-annual and in some cases quarterly statements are subject to review as well. Auditors must provide an opinion on the accounts, but the laws do not spell out the required contents of these opinions. FIBA and the SEA require the auditor to report suspected fraud, while the PLC Act provides for appointment of special inspectors when a reasonable suspicion of fraud or serious illegality arises. The accounting and audit profession is subject to stringent qualification requirements and overseen by the professional membership body, FAP. Earlier reports have suggested that oversight might be strengthened by moving it more fully into an independent supervisory body. On the other hand, penalties applicable to accountants, auditors, companies, directors, and officers are in some cases quite serious – particularly the prison terms applicable to individuals. The quality of enforcement, however, has been questioned.

Recommendations

1) Prohibit the main techniques of account and record manipulation used to disguise corruption – including off-the-books activities.
2) Strengthen financial reporting standards. Require disclosure of prospective legal liability for acts of corruption in financial reports, as a contingent liability.
3) Improve rules and oversight of audit. Provide for required content of audit opinions, and strengthen and standardize audit quality norms and oversight for all company audits. Adopt a requirement for auditors to report fraud and corruption in all statutory private sector audits, along with a stronger safe harbor provision to shield the auditors from liability.
4) Strengthen governance of the accounting and audit profession by moving more disciplinary and oversight functions to an autonomous or governmental body. Adopt more rigorous and detailed safeguards for auditor independence, including restrictions on non-audit work, directorships and family ties to audited companies.
5) Law enforcement agencies in Thailand should work closely with relevant bodies to strengthen the enforcement of laws, including stronger penalties.

Thailand Laws, Regulations, Policy Documents Referenced:

Accounting Act, B.E. 2543 (2000), http://www.track.unodc.org/LegalLibrary/pages/LegalResources.aspx?country=Thailand.

Accounting Professions Act, B.E. 2547 (2004), http://en.fap.or.th/images/introc_1364528051/Accountancy%20Act%20%28Eng%29.pdf.

Anti-Money Laundering Act B.E. 2542 (1999).
Financial Institution Business Act, B.E. 2551.
Policy Statement: The SET Code of Best Practice for Directors of Listed Companies (Bor.Jor/.Ror.26-00), http://www.set.or.th/dat/content/rule/en/BorJorRor26-00_ENG.pdf.
Principles of Good Corporate Governance For Listed Companies, Stock Exchange of Thailand, 2006, http://www.ecgi.org/codes/documents/cg_principles_thailand_2006_en.pdf.
Public Limited Company Act, B.E. 2535 (1992), http://www.asianlii.org/th/legis/consol_act/plca1992223/.
Securities and Exchange Act, B.E. 2535.

NOTES

1 *Source:*http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/thailand/show-all.aspx, http://www.bti-project.org/reports/country-reports/aso/tha/index.nc.

2 *Source*(except as indicated):http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/thailand/show-all.aspx.

3 Government comments.

4 US State Department (2012), *Country Reports on Human Rights Practices for 2012: Thailand*, Bureau of Democracy, Human Rights and Labor, Section 4. “Corruption and Lack of Transparency in Government,” http://www.state.gov/j/drl/rls/hrrpt/2012humanrightsreport/index.htm?year=2012&dlid=204241#wrapper.

5 NACC Organic Act on Counter Corruption B.E. 2542 (1999) amended in B.E. 2550 (2007) and (No.2) B.E. 2554 (2011);NACC Regulation. Government comments.

6 Anti-Money Laundering Act B.E. 2542 (1999); questionnaire responses: government, professionals, businesses.

7 Government comments.

8 Organic Act on Counter Corruption B.E. 2542 (1999) (as amended in B.E. 2550 (2007) and (No. 2) B.E. 2554 (2011)); questionnaire responses: government, professionals, businesses.

9 *Measures Undertaken to Implement UNCAC provisions since the 18th Steering Group Meeting in July 2013: Thailand* (August 2014), Art. 5: Preventive anti-corruption policies and practices.

10 http://www.sec.or.th/EN/RaisingFunds/EquityDebt/Pages/link-Laws_Regulations/CorporateGovernanceCG.aspx.

11 Here and previous paragraph: questionnaire responses of government, professionals, businesses.

12 http://www.thai-iod.com; questionnaire responses: government, professionals, businesses.

13 The sources of all standards are provided in footnotes to the tables presented in the section of the Review entitled *International Standards for Country Reports.*

[14] *Principles of Good Corporate Governance For Listed Companies*, Stock Exchange of Thailand, 2006, http://www.ecgi.org/codes/documents/cg_principles_thailand_2006_en.pdf.
[15] http://www.theiiat.or.th/; questionnaire responses: government, professionals.
[16] World Bank (2005), *Report on the Observance of Standards and Codes (ROSC): Corporate governance country assessment*, *Thailand*, p. 14
[17] Notification of the SET (Bor.Jor./Ror. 01-04),*Qualifications and Scope of Work of the Audit Committee*.
[18] BOT guideline on internal audit; questionnaire responses, government and accounting profession.
[19] *Policy Statement: The SET Code of Best Practice for Directors of Listed Companies* (Bor.Jor/.Ror.26-00), art. 2.1.13, http://www.set.or.th/dat/content/rule/en/BorJorRor26-00_ENG.pdf, http://www.sec.or.th/TH/RaisingFunds/EquityDebt/Documents/AChandbook.pdf; SEC(Capital Market Supervisory Board) Notification No.TorChor.28/2551;questionnaire responses, government and accounting profession.
[20] Notification of the SET, *Qualifications and Scope of Work of the Audit Committee*,Bor.Jor./Ror. 01-04; SET Code of Best Practice; SEC Notification TorChor. 28/2551.
[21] Questionnaire responses, government and accounting profession.
[22] Some of the major companies in Thailand responded to questionnaires and shared their codes of conduct, including anti-corruption standards.
[23] Financial Institution Business Act, B.E. 2551, art. 41.
[24] BOT Notification regarding Corporate Governance for Financial institutions; BOT Notification regarding the Board of Directors' authorities and duties; BOT guideline on operational risk management; BOT guideline on compliance; BOT outsourcing guideline; Law on Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT); government questionnaire responses.
[25] SEC Circular No.SEC.KorTor. (Wor) 23/2014 encourages securities companies to establish risk management systems to prevent the use of securities businesses for money laundering and financing of terrorism. As reported in*Measures Undertaken to Implement UNCAC provisions since the 18th Steering Group Meeting in July 2013: Thailand* (August 2014), Art. 23: Laundering of proceeds of crime
[26] The Capital Market Supervisory Board has also issued rules in this area, requiring issuers and securities companies to follow, and report on, corruption prevention policies. Notification of the Capital Market Supervisory Board No. TorChor. 44/2556 Re: Rules, Conditions and Procedures for Disclosure regarding Financial and Non-financial Information of Securities Issuers; Notification of the Capital Market Supervisory Board No. TorThor. 35/2556 Re: Standard Conduct of Business, Management Arrangement, Operating Systems, and Providing Services to Clients of Securities Companies and Derivatives Intermediaries. As reported in *Measures Undertaken to Implement UNCAC provisions since the 18th Steering Group Meeting in July 2013: Thailand* (August 2014), Art. 5: Preventive anti-corruption policies and practices.
[27] Committee of Sponsoring Organizations of the Treadway Commission, an international standards body on corporate governance.

[28] Life Insurance Act; Non-life Insurance Act; SEC Notification TorChor. 44/2556 (Rules, Conditions and Procedures for Disclosure regarding Financial and Non-financial Information of Securities Issuers)

[29] Accounting Act, B.E. 2543 (2000), http://www.track.unodc.org/LegalLibrary/pages/LegalResources.aspx?country=Thailand.

[30] These rules include the Department's Announcement on the Type of Accounts, Contents, and Items to be listed in the Account, Time Period for Accounting Records, and Reference Documents B.E. 2544 (2001), http://www.dbd.go.th/ewt_news.php?nid=1086&filename=law06 and Announcement on the Type of Accounts, Contents, and Items to be listed in the Account, Time Period for Accounting Records, and Reference Documents (No.2) B.E. 2552 (2009), http://www.dbd.go.th/download/PDF_law/Pragard_DBD_Kamnodchanidbanshe_2_2552.pdf.

[31] Public Limited Company Act, B.E. 2535 (1992), http://www.asianlii.org/th/legis/consol_act/plca1992223/.

[32] Responses to questionnaires: government and accounting profession.

[33] *Measures Undertaken to Implement UNCAC provisions since the 18th Steering Group Meeting in July 2013: Thailand* (August 2014), Art. 5: Preventive anti-corruption policies and practices.

[34] http://www.ifrs.org/Use-around-the-world/Documents/Jurisdiction-profiles/Thailand-IFRS-Profile.pdf; http://www.adoptifrs.org/CountryDescription.aspx?CID=210.

[35] http://www.ifrs.org/Use-around-the-world/Documents/Jurisdiction-profiles/Thailand-IFRS-Profile.pdf; Action Plan Developed By Federation of Accounting Professions (FAP), p.21, http://www.ifac.org/sites/default/files/compliance-assessment/part_3/201402%20Thailand%20FAP.pdf; World Bank (2008), *Report on the Observance of Standards and Codes (ROSC): Kingdom of Thailand – Accounting and Auditing*, p.4, http://www.worldbank.org/ifa/rosc_aa_thailand.pdf.

[36] http://fap.or.th.a33.readyplanet.net/images/column_1359010309/TAS27.pdf; responses to questionnaires: government and accounting profession.

[37] http://fap.or.th.a33.readyplanet.net/images/column_1359010309/NPAE_ web_060554.pdf;http://fap.or.th.a33.readyplanet.net/images/column_1359010309/TAS37.pdf, responses to questionnaires: government and accounting profession.

[38] World Bank (2008), Report on the Observance of Standards and Codes (ROSC): Kingdom of Thailand – Accounting and Auditing, p.4, http://www.worldbank.org/ifa/rosc_aa_thailand.pdf.

[39] For this and later references to the World Bank (2008) report, see footnote 38 above.

[40] TSA 315, 330, 580, 700; responses to questionnaires: government and accounting profession.

[41] Sections 281/2, 305, 306, 308-313; responses to questionnaires: government and accounting profession.

[42] Responses to questionnaires: government and accounting profession.

[43] Accounting Professions Act, B.E. 2547 (2004), http://en.fap.or.th/images/introc_1364528051/Accountancy%20Act%20%28Eng%29.pdf.

[44] The International Federation of Accountants (IFAC) and the International Ethics Standards Board for Accountants (IESBA). The latter is an independent standard-setting body for professional accountants, affiliated with IFAC.

[45] www.fap.or.th; responses to questionnaires: government and accounting profession.
[46] Responses to questionnaires: government and accounting profession.
[47] According to the Notification of the Office of the SEC No.SorShor.39/2553, According to Notification of the Capital Market Supervisory Board No.TorChor.44/2556 (See Attachment# 3),(World Bank 2008: 7-16).
[48] All currency conversions are at the interbank rate as of April 5, 2014, http://www.oanda.com/currency/converter/.
[49] However, government reports that NACC has submitted to the National Legislative Assembly draft bills designed to increase NACC's effectiveness in corruption prevention and suppression, and, in particular, to comply with the country's obligations under the UN Convention against Corruption (UNCAC). The draft bills include criminalizing foreign bribery as required by Article 16 of the UNCAC.

Vanuatu

1. Introduction[1]

Vanuatu contends with several challenges inherent to the Pacific island nations. These include small scale (with a population estimated at 260,000 in 2013), dispersion (it is comprised of 83 islands, with the extremes 1000 kilometers apart), and its relatively brief experience as an independent nation (beginning in 1980). But Vanuatu has fared better than most.

Vanuatu's economy is small, with GDP at current prices estimated at VT 72.6 billion (USD 764 million) in 2012, and per capita GDP of VT 288,090 (USD 3,033). It is also open, with few trade restrictions and substantial imports of a wide range of goods. However, Vanuatu relies on a limited range of exports, and has experienced volatile foreign investment in recent years. The economy has become increasingly dualistic in the past 20 years as the relative importance of agriculture declined and the significance of the services sector, which is found almost exclusively in the urban areas (particularly the capital, Port Vila) grew continuously. The economy is now heavily service-based, despite the fact that around 75% of the population lives in rural areas and most depend on agriculture for their livelihood.

The economic data indicate that the economy has a narrow base, with services relating to tourism and hospitality, along with real estate, construction and financial services, of particular importance in the past five years. Commercial agriculture has stagnated in recent years, as exports of goods are in most cases declining due to improved supply of globally traded commodities. Conversely, imports have grown in line with the construction boom in recent years, the greater use of private credit, and increasing transport services.

Vanuatu does not have its own formal stock exchange, although the country has several policies in place to encourage foreign investment. Vanuatu imposes no income, corporate, capital-gains, withholding or estate taxes. The International Companies Act provides a 20-year period of exemption from taxes for all international companies from the date of incorporation. The offshore financial sector has grown significantly, but with a lag in oversight. In response to foreign concerns, the government has promised to tighten regulation of the center. Like the other island states, Vanuatu hosts many foreign businessmen and professionals, who are critical to sustaining the economy in a situation where local capacity is constrained. The Vanuatu–Australia Partnership for Development seeks to contribute here, with programs in such areas as education, infrastructure, economic governance, and the justice sector.

2. General efforts to prevent corruption involving the private sector

Vanuatu has activities in this area initiated by Government, but more often by NGOs and private sector associations. On the government side, the Ombudsman responds to citizen complaints and seeks to raise awareness about good governance, including prevention of corruption. The Vanuatu Investment Promotion Authority (VIPA) also provides information and advice, and facilitates dealings between businesses (especially foreign) and state administrators and regulators. As for non-governmental efforts, the Vanuatu Chamber of Commerce and Industry (VCCI) and others are active in informing, organizing, and representing the private sector on policy and governance issues.

Another non-governmental actor is Transparency International-Vanuatu (TIV), an affiliate of Transparency International. TIV has been raising awareness on good governance and corruption through civic education, workshops, and publications in the media. The organization seeks to build a coalition against corruption by working with government departments, parliamentarians, other NGOs, and various civic networks. TIV has a dedicated team responsible for monitoring the media. It conducts awareness workshops throughout the archipelago, emphasizing remote and rural areas where information on these topics is limited.[2]

International standard[3]	Compliance by member country
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	Some general anti-corruption activities underway involving government, private sector, NGOs, and international donors.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) The Ombudsman provides a channel for complaints and reporting. 2) There appears to be no formal provision for sentence mitigation in these circumstances.
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) Outreach and cooperative efforts are reported, but sustained partnerships are not in evidence. 2) and 3): TIV and Chamber of Commerce carry out supportive activities, but Vanuatu's small scale means it looks to established external models for detailed standards and guidelines (see below).
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	Integrity pacts do not appear to be used to any significant extent. Private sector associations and NGOs advocate ethics and good governance.

3. Internal controls

A. Internal audit

Vanuatu does not have a national requirement or standard for internal auditing. There is no formally organized accounting or audit profession in the country, and no chapter of IIA. Internal audit is practiced, but there appears to be no professional structure for it. While companies generally are not required to have an internal audit function, banks and related financial services providers are strongly advised to do so. The Reserve Bank of Vanuatu (RBV) in its prudential guidelines[4] states that banks should have a comprehensive and independent internal audit process for reviewing and testing their internal controls and risk management systems. Where the scale of a bank's operations does not justify maintaining a full time internal audit function, the bank should agree to alternative review arrangements with the Reserve Bank. The internal audit scope should include a review of compliance with laws, regulations and the Reserve Bank's prudential guidelines. Internal auditors should be represented in tripartite meetings with the Reserve Bank, the bank and its external auditor. RBV has also issued audit and internal control standards for insurance companies.

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	Companies generally not required to have internal audit, though some firms do, especially international firms with a presence in the country.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect "illegal acts" in the books and records of companies, including bribery and other forms of corruption.	1) No structured internal audit profession or association. 2) Banks per RBV Guideline: Internal auditor duty to review compliance with laws and regulations for financial institutions. No explicit mention of corruption
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	Financial institutions, per RBV Guideline: 1) Prudential guidelines require internal audit or equivalent process for review of finances, reporting, and controls. 2) Internal audit to include reviewing and testing internal controls and risk management systems. 3) Internal audit includes review of legal-regulatory compliance. No express provision on corruption. 4) Internal audit should be independent, but no details mentioned.

B. Audit committee

Some company policies specify an audit committee, but there is no general legal requirement for this. Here again, RBV Guideline No. 5 (paras.9-10) makes this a prudential standard for the financial sector. The board of a bank should establish an audit committee to oversee financial and management reporting, audit (both internal and external), as well as risk management processes, including the formulation and periodic review of the bank's "business continuity plan." The committee should review the external auditor's engagement every year, and in the process, remind auditors of their statutory obligations. The committee should have a majority of non-executive directors, and should avoid appointing the chairman of the company board to chair the audit committee.

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	1) No general requirement for companies to maintain audit committee. Prudential standard strongly suggests banks should do so. 2) Bank audit committees to have majority of non-executive directors and not have board chair as committee head.
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers, employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	Financial institutions, per RBV Guideline: 1) Audit committee to oversee internal and external audit, financial reporting. 2) Committee to review risk management processes and related plans. 3) through 5): No provision.

C. Internal control and compliance systems

As above, there is no general legal or regulatory requirement here, although questionnaire responses suggest that internal control and compliance are viewed as necessary by leading businesses. The Reserve Bank provides standards in Guideline No. 5. Part of the responsibility of a bank's board and management in meeting prudential requirements is to limit risks to appropriate levels. Risk management practices must be set forth in detailed system descriptions, which should be regularly reviewed and updated (at least annually) to take account of changing circumstances. A bank is required to provide RBV with descriptions of its risk management systems covering all major areas of risk, and keep it informed of all material changes to its risk management systems descriptions as they are made. The bank must provide RBV annually a "declaration" by the CEO and endorsed by the board attesting that, for the past financial year, the board and management have identified the key risks facing the bank and have established systems to monitor and manage those risks, including the setting of prudent limits and reporting processes. The declaration must further state that the risk management systems are operating effectively, and that the system descriptions held by the Reserve Bank are accurate and current. If a bank feels it needs to qualify the declaration it must explain the reasons for the qualifications as well as provide plans for corrective action. Risk management, of course, is an important aspect of banking globally, and so it is not surprising that the financial sector in Vanuatu is ahead of others in this regard.

International standard	Compliance by member country
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees. 4) Risk-based approach: • Individualized assessment of risks to the enterprise, including corruption risks. • Regular monitoring and re-	1) Financial institutions, per RBV Guideline: Description of risk management systems and CEO declaration attesting their effectiveness must be submitted to RBV. 2) and 3): No provision. 4) Financial institutions, per RBV Guideline: Assessment of specific bank-related risks required, also review and update of system description. Corruption not expressly mentioned, but this would fall within operational risks of banking.

assessment of corruption risks.	
Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements. 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations. 4) Require for third-party representatives, consultants, or agents: • Written contract, adherence to company ethics standards and anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	1) Financial institutions, per RBV Guideline: Legal compliance to be monitored by internal auditor. 2) through 4): No express provision.
Enforcement, including sanctions for failure to comply.	For banks, the standards here are enforced as prudential norms by RBV.

4. Integrity of financial statements

A. Accounting

1. Financial records

The Companies Act[5] (art.148) addresses retention of records. All companies must keep proper books of account with respect to money received and expended, sales and purchases of goods and assets and liabilities of the company. The records must be sufficient to give a true and fair view of the state of the company's affairs and to explain its transactions. Hard copy or electronic records are acceptable, and records are to be kept in Vanuatu or if not, records and returns must be kept in the country sufficient to disclose the financial position of the business, and prepare financial statements, at intervals of 12 months. The books, accounts, and returns must be kept for five years. Company directors are liable to fines and imprisonment for failure to take all reasonable steps to comply, or for wilful non-compliance. Making a wilful false statement in any document or return is subject to fines and imprisonment (art.398). The Financial Institutions Act[6] (arts.52, 54) further requires that banks retain checks, bills of exchange, and other documents for six years (beginning from their due date, as applicable), in hard or electronic copy format. A director, officer, or agent of a financial institution is liable to fines and imprisonment for intentionally making a false or misleading entry in a book or document, providing false information, omitting or concealing book entries, or concealing or improperly destroying records or documents.

International standard	**Compliance by member country**
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	Per Companies and Financial Institutions Acts: All companies to keep accurate records and documents for 5 years (banking documents: 6 years).
Prohibitions (UNCAC 12(3), OECD Convention 8(1)), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	1) and 2): Per Companies and Financial Institutions Acts: False statements in records or documents punishable by fines and imprisonment, as are concealment and improper destruction. 3) and 4): No explicit prohibition, but falls within “true and fair” requirement. 5) and 6): No explicit prohibition, but falls within rule against false statements, if intentional.

2. *Financial reporting requirements*

As mentioned, Vanuatu does not have its own national standards on accounting and financial reporting. Since there are legal requirements in this area for companies, financial reports are prepared in accordance with accepted standards, usually a version of IFRS.

The Companies Act (art.149C) requires all public companies (i.e. all that are not private) to prepare annual financial statements, along with any private company with annual business turnover above VT 20 million (USD 207,000). These entities must submit annual balance sheets and profit-and-loss accounts, along with directors' and auditors' reports on the accounts, to the AGM and the Company Registrar. Two directors must sign the company balance sheet on behalf of the board, and the profit-and-loss account is to be attached to it along with any group accounts and auditor's report. A directors' report signed by one of the directors, including information prescribed by regulation, is also to be submitted with the financial statements. All of the above documents must be provided to the holders of shares and debentures in the company 21 days before the AGM. Any director failing to ensure compliance with these requirements is subject to fines, and in the case of failure to submit the directors' report as required, imprisonment (arts.159-162).

The financial statements (balance sheet and profit-and-loss statement) are to give a true and fair view of the state of the company's affairs (art.150) and comply with accounting rules set forth in the Act (Schedule 6) – unless the company has subsidiaries and complies with standards for consolidated financial statements. A company director who fails to take all reasonable steps to comply with these requirements is subject to fines and imprisonment. The Act (arts.151-158) includes detailed provisions relating to the definitions of subsidiaries and holding companies, and the duties of holding companies to identify their subsidiaries and to produce consolidated financial statements. The latter duties may be waived, with the approval of the Registrar, where they would be unreasonable or produce misleading results. Group accounts must, as a whole, give a true and fair view, and comply with the accounting rules in the Act.

International standard	Compliance by member country
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) and 2): No national accounting standards. IFRS used as basis for reporting. Per Companies Act, public companies and private firms above a turnover threshold must prepare financial statements. 3) Companies Act requires consolidated reporting for holding companies and subsidiaries. IFRS 10 deals with the other matters, but IFRS are not required by law.
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) IAS 37 requires disclosure of such liabilities, though normally not prospective liability for acts of corruption. IAS/IFRS not officially adopted as national standards. 2) Companies Act prohibition of false statements and concealment applies, but no explicit reference to fraud or corruption.

B. Audit

1. Auditing requirements

The basic audit requirements are given in the Companies Act (arts. 163-167). Every company required under the Act to prepare financial statements must appoint external auditors at the AGM for the coming year. Companies not so required may appoint and remove auditors at their own initiative, and the Registrar may seek a court order appointing an auditor if it sees fit. The auditors are to report on the accounts examined by them, and these reports are to be read at the AGM and be kept open to inspection by the shareholders. The report must state the auditor's opinion as to whether the company's balance sheet and profit and loss account and any group accounts have been properly prepared in accordance with the Companies Act, and whether a true and fair view is given of the state of the company's (or group's) affairs and its profit and loss for the year. The auditor is also to state that she/he is qualified (including not having a disqualifying relationship with the company).

Auditors have a duty to investigate sufficiently to determine if the company has kept proper books of account (and proper returns made by branches), and whether the financial statements are in agreement with the books. When either of these is not the case, the auditor is to state this in the report. Auditors have the right of access to the books, records, and accounts of the company, and are entitled to demand any information and explanations necessary for the audit. If the auditor does not obtain such information, this is to be stated in the audit report.

Parallel provisions on bank audits are contained in the Financial Institutions Act (arts.22-27). Auditor appointments are to be approved in writing by the Reserve Bank of Vanuatu (RBV), and are subject to disapproval in cases of potential conflict of interest. Audit reports of foreign-licensed banks are not required where RBV determines that the institution has met home-country audit requirements and RBV is provided a copy of the relevant audit documents. Auditors are required to comply with any request by the RBV to discuss an audit of a financial institution, and the auditor must inform the audited institution of this. Further, banks are to submit to the RBV the audited financial statements, along with the audit report and directors' report, and must publish the audited financials in the Gazette and a newspaper. Any director, officer, employee, or agent of a financial institution who attempts to obstruct an auditor or who falsifies information is subject to fines and imprisonment.

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	Whether the controls are sufficient for anti-corruption purposes is unclear.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	1) and 2): Per Companies Act, all companies required to prepare financial statements must have them audited annually. Private companies below threshold not required to do so.
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	No national audit standards, but auditors use ISA. Whether they use the ISA in whole or in part is not clear.
Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks. 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	Per Companies Act and Financial Institutions Act: 1) Auditor to state in report whether financial statements are true and fair, properly prepared, and in agreement with books and records. No provision on testing risk management controls. 2) Certification by CEO/CFO not required, though signature by directors is. Falsifying information is penalized, and for banks any attempt to obstruct the auditor is penalized. Cooperation with auditor required in all cases.

2. Auditor reporting of improprieties

For companies generally, there is no duty for the auditor to report fraud, corruption, or other illegality to the company itself or to external authorities. Since Vanuatu has not officially adopted the International Standards on Auditing (ISA), ISA 240 and 250 are not mandatory even though the ISA as a whole are regarded as best practice standards. Also, no formal professional standards apply to auditors except to the extent they are licensed by a foreign country.

In the financial sector, however, there are certain external reporting duties provided in the Financial Institutions Act (arts.23-26). Most important, art.23(3) requires an auditor to report immediately to VRB if a criminal offence involving fraud or dishonesty has been committed or serious irregularities have occurred, including any that jeopardize the interests of depositors and creditors. Failure to report is subject to fines and imprisonment. Art.26 provides a “safe harbor” protecting the auditor from liability for submitting any of the required reports or information to RBV. The latter may also request a report from the auditor on an institution’s state of affairs including its compliance with prudential standards and the quality of its risk management. Further, RBV Prudential Guideline No. 5 (paras.14-19) provides that auditors should report to the Reserve Bank within three months of the close of the financial year on several financial and prudential matters. This report must state whether the bank has complied with all statutory requirements and other conditions imposed by RBV, and whether there are any matters that “may have the potential to prejudice materially the interests of depositors of the bank.”

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	Vanuatu has not formally adopted the ISA, though these are generally followed. ISA 240 and 250 advise reporting all such matters to management and the board. Otherwise, no general duty to report.
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith (“safe harbor”).	1) and 2): There is no general duty for auditors to report to external authorities. ISA 240 and 250 are informally followed, but do not usually require such reporting. Financial Institutions Act does require auditors to report criminal fraud and dishonesty, as well as irregularities that may affect depositors and creditors. Safe harbor is provided to relieve auditors of potential liability.

C. Professional standards and independence

There is no local professional body for accountants or auditors in Vanuatu. However, there are many accountancy, tax, and audit consultancy firms in the country thanks to its role in the South Pacific as a financial center and tax haven. Rising professionals in Vanuatu may qualify by following Association of Chartered Certified Accountants courses online, and taking the exams in Australia or New Zealand.[7] Such international credentials are recognized in Vanuatu, and they bring with them the home-country ethics codes, professional standards, and continuing education requirements.

The Companies Act (arts.163-166) provides for the appointment and independence of auditors. Incumbent auditors are to be reappointed without any resolution being passed unless unqualified or replaced by resolution, or if the auditor is unwilling to be reappointed. The Registrar may appoint an auditor if a company fails to do so. Where a resolution is passed not to reappoint an auditor, the retiring auditor has the right to make representations that must be provided to the shareholders. To qualify for appointment as an auditor, a person must be a member of a professional accountancy body in Vanuatu or a foreign association recognized by the government, or the person must be authorized by the relevant ministry as having equivalent expertise. The following may not be appointed as an auditor of a company: an officer or employee of the company or the business partner of such person, a corporation, one who does not hold a valid business license, and one who is disqualified from being an auditor for the entity's subsidiary or holding company. An unqualified person serving as a company auditor is subject to fines.

The Financial Institutions Act (arts.22-23) provides some additional rules for bank auditors. Anyone having a financial interest in the bank, other than as a depositor, may not serve as its auditor. An appointment as auditor ceases when the auditor becomes a director, officer, employee, or agent of the company or acquires a financial interest (other than deposit). A financial institution must give VRB three months' notice in writing of its intention to terminate an auditor's appointment, and must provide reasons for the decision.

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) and 2): In the absence of national standards, codes, and professional organization, foreign credentials and rules are recognized as appropriate by the government.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	Per Companies and Financial Institutions Acts: 1) Appointment and removal are by AGM resolution. 2) and 3): No provision. 4) Auditors disqualified if employed by audited company, or have financial interest in audited bank. 5) No provision.
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) Business license and membership in a recognized professional body required. 2) through 4): All such standards are determined by the (foreign) professional body to which the auditor belongs.

D. Enforcement

The two Acts discussed above stipulate penalties for offenses related to records, financial reporting, and auditing. Following are several examples:

Companies Act:

- Concerning record-keeping, preparation and submission of financial statements, inaccurate or non-conforming financial statements, and submission of the directors' report: any director failing to ensure compliance is subject to fines up to VT 100,000 (USD 1,000) or imprisonment up to six months (in most cases, imprisonment requires wilful violation) (arts.148, 149C, 150, 161).
- For issuing or circulating a balance sheet not signed or not having attached the profit-and-loss account or auditor's report: the company and every officer in default liable to fines up to VT 10,000 (USD 100) (arts.159-160).
- Anyone serving as auditor of a company without being qualified for appointment is liable to fines up to VT100,000 (USD 1,000) (art.166).
- Anyone wilfully making a statement that is false in any material particular in a report, financial statement, or other document required by the Act is liable to fines up to VT 500,000 (USD 5,200) and imprisonment for up to two years (art.398).

Financial Institutions Act:

- An auditor who fails to report to VRB that a criminal offence involving fraud or dishonesty has been committed or serious irregularities have occurred at a financial institution (as well as other items required to be reported) is subject to fines up to VT 1 million (USD 10,300) and imprisonment for up to two years including any that jeopardize the interests of depositors and creditors (art.23(3A)).
- A director, officer, employee, or agent of a bank who intentionally provides false or misleading information or enters it into any book or document; or who omits an entry or conceals or destroys any information, book, or document relating to the bank's accounts or business; or who attempts to obstruct an audit or regulatory inspection is subject to fines up to VT 1 million (USD 10,300) and imprisonment up to one year (art.54).
- A bank that fails to submit or publish its financial statements is subject to fines up to VT 500,000 (USD 5,200) (art.27).

- Anyone who otherwise fails to comply with the requirements of the Act, or abets an offense under the Act, is subject to fines up to VT 250,000 (USD 2,600) (art.59).

International standard	Compliance by member country
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2): Accounting and audit standards are not fixed according to law, and so would appear to be difficult to enforce.
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	Per Companies and Financial Institutions Acts: 1) Maximum penalties are fines of USD 10,300 and imprisonment up to 2 years for failing to issue proper financial statements or falsifying information. 2) Some penalties apply to companies or banks themselves. 3) Quality of enforcement unclear.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	Per Companies and Financial Institutions Acts: 1) Maximum penalties are fines of USD 10,300 and imprisonment up to 2 years for audit violations including auditor failure to report fraud to VRB. 2) Some penalties apply to companies or banks themselves. 3) Quality of enforcement unclear.

5. Conclusion and recommendations

A. General efforts to prevent corruption involving the private sector

Vanuatu has some public-private activities on corruption prevention, including outreach and cooperative efforts led by the Ombudsman, but sustained partnerships are not in evidence. The civic sector appears more active, with Transparency Vanuatu and the VCCI conducting training and awareness-raising on good governance. Vanuatu's small scale means it looks to established external models for detailed standards and guidelines. Integrity pacts do not appear to be used to any significant extent.

Recommendations

1) Encourage outreach by the Ombudsman, and other government departments as appropriate, to the private sector. Focal points could be anti-corruption workshops and training, reporting and whistle-blowing, and development of a corporate governance code.
2) Support integrity pacts involving commitment by businesses to anti-corruption standards, and self-policing with cooperation by NGOs. Pacts could focus on construction and tourism projects.
3) Link up to Australian and Pacific island initiatives on combating corruption in the private sector, to gain from economies of scale and cross-country learning.

B. Internal controls

There are no general legal requirements for companies to establish internal audit, audit committees, or internal control and compliance systems. However, prudential guidelines applicable to banks (and similar norms for insurance companies) address these points, allowing some flexibility in the design of these functions while according the RBV authority to use the guidelines as regulatory standards. This is not to say that non-financial companies do not have these functions, but there are no legal provisions or codes to ensure that such practices are appropriately established. Since Vanuatu does not have its own stock exchange, and is not highly oriented to outbound foreign investment, internal controls have not been a focus of corporate governance. Where controls are required, as in the banking system, the norms do not emphasize corruption-related risks.

Recommendations

1) Consider broadening the internal control standards beyond the financial sector to include all publicly-accountable companies and others that are required to prepare financial statements. Requiring an audit committee or equivalent could be a starting-point.
2) Incorporate corruption-related risk controls into internal compliance systems for banks and eventually other publicly-accountable companies. Audit committees could be tasked with providing guidance on internal anti-corruption standards, and emphasis could usefully be placed on risks involved in gift-giving, and contributions to political and charitable causes.

C. Integrity of financial statements

The Companies and Financial Institutions Acts govern this area. They require proper keeping of accounting documents for five (or for banks, six) years, and prohibit improper destruction and falsification. Financial statements must be prepared by all public companies and all private firms above a defined threshold. The statements must be submitted to the Registrar, and in the case of banks, sent to RBV and published. Vanuatu has not adopted its own accounting or audit standards, and relies on companies to respond to investor and regulator needs by using international standards – IFRS and ISA. But these are not legally required, and it is not clear to what extent they are respected (nor what version). Audits are required for all companies that must prepare financial statements. Directors' statements and auditor reports must be attached. Vanuatu requires bank auditors to report fraud and serious irregularities to RBV, and has a safe harbor provision protecting such auditors from liability. Though the rule applies only to financial institutions, it is a step ahead of many other countries. In the absence of national standards or a professional governing body for accountants or auditors, Vanuatu accepts the credentials of professionals who qualify in other recognized jurisdictions. Appointment and independence standards are reasonable for bank auditors, and minimal for others. Sanctions applicable to many of the above provisions appear rather light in many cases, though reasonably heavy fines and prison terms apply in other cases including falsification of information and failure by a bank auditor to report fraud to the regulator. The quality of enforcement is unclear.

Recommendations

1) Extend document retention period to seven years.
2) Designate specific versions of IFRS and ISA to be applied uniformly to all audited financial statements. Consider permitting IFRS for SMEs to be used by companies within a higher size threshold than VT 20 million in turnover (USD 207,000). Ensure that accountants

and auditors remain in good standing in the jurisdictions where they are qualified, perhaps through annual filings.

3) Consider broadening audit-related standards for banks to most or all public companies. This should include conflict-of-interest rules and auditor reporting of fraud and other irregularities.
4) Revisit sanctions and consider raising them to deterrent levels (monetary fines in particular).

Vanuatu Laws, Regulations, Policy Documents Referenced:

Companies Act (Cap.191), Consolidated Edition 2006, http://www.paclii.org/vu/legis/consol_act/ca107/

Financial Institutions Act [Cap 254], 1999, Consolidated Edition 2006, http://www.paclii.org/vu/legis/consol_act/fia258/.

Reserve Bank of Vanuatu, Domestic Banks Prudential Guideline No. 5: Audit Arrangements (paras.11-13), http://www.rbv.gov.vu/attachments/139_Prudential%20Guideline%205.pdf.

NOTES

[1] *Sources:* ADB, *Pacific Economic Monitor*, Dec. 2013, www.adb.org/pacmonitor; http://www.commonwealthofnations.org/sectors-vanuatu/business/accountancy_audit_and_tax/; https://www.cia.gov/library/publications/the-world-factbook/geos/nh.html; http://www.dfat.gov.au/geo/vanuatu/vanuatu_brief.html; http://www.adb.org/publications/vanuatu-fact-sheet?ref=countries/vanuatu/publications; government comments.

[2] http://www.governance.usp.ac.fj/top-menu-29/thematic-areas-236/hidden-pages/peace-and-security-242/pacific-based-ngos-involv-419/ti-vanuatu-464/.

[3] The sources of all standards are provided in footnotes to the tables presented in the section of the Review entitled *International Standards for Country Reports.*

[4] Reserve Bank of Vanuatu, Domestic Banks Prudential Guideline No. 5: Audit Arrangements (paras.11-13), http://www.rbv.gov.vu/attachments/139_Prudential%20Guideline%205.pdf.

[5] Companies Act (Cap.191), Consolidated Edition 2006, http://www.paclii.org/vu/legis/consol_act/ca107/.

[6] Financial Institutions Act [Cap 254], 1999, Consolidated Edition 2006, http://www.paclii.org/vu/legis/consol_act/fia258/.

[7] http://www.commonwealthofnations.org/sectors-vanuatu/business/accountancy_audit_and_tax/

Viet Nam

1. Introduction

Viet Nam's efforts to attract foreign investment and improve the business climate have in large part driven its anti-corruption measures. The country has adopted reforms making it easier to conduct business, including the establishment of a one-stop shop to obtain business and tax licenses. Viet Nam has also embarked on a reform policy of decentralization, granting greater authority over investment licensing to the provinces, municipalities and investment zones. The ruling Communist Party of Viet Nam (CPV) has made it a key objective to build a state governed by law. It has pledged to streamline government institutions, tackle corruption and make the state more responsive to public demands – a process that started with the *DoiMoi* (“renovation”) Policy reforms of the 1980s.[1]

The Vietnamese economy has shown continual improvement since DoiMoi got underway.Per capita GDP in 2012 reached USD 1,523, considered middle-income. The informal sector accounts for about 20% of GDP and 24% of employment. International trade and inflows of foreign direct investment – mainly into export-oriented manufacturing – have been the main drivers of growth. Since the 1980s, Viet Nam has made impressive efforts to liberalize its foreign trade. But the national currency is not fully convertible, and the State Bank of Viet Nam maintains strict currency controls. State-owned enterprises control around 40% of the country’s economic output, and enjoy near-monopoly status in many sectors. But the private sector has steadily grown in importance, and contributes roughly 60% of the country’s GDP. The government pledged to accelerate the restructuring and privatization of unprofitable SOEs, but not much progress has been achieved.[2]

Corruption poses serious challenges in Viet Nam as it generally does in countries making large-scale transition from state control toward a liberal or mixed approach to political and economic governance. Thus, decentralization promises greater local government initiative and responsiveness, but the increased discretion afforded to local officials is subject to abuses such as demands for bribes to issue licenses and permits. In a 2013 World Bank survey, land administration was most frequently reported to be the most corrupt sector (about 60% of officials, businesses, and citizens surveyed) followed by construction licensing (20-30%).[3] In surveys since 2000, businesses have reported having to pay commissions when participating in public bids.[4] This problem gained public notoriety due to a construction kickback scandal revealed in 2009, involving a Japanese company bidding on a major infrastructure project in Ho Chi Minh City. Within the business sector, few companies have codes of conduct or programs to encourage integrity in the procurement process.[5]

The government has been quite active over the past decade in establishing the necessary norms and structures for combating corruption. In September 2008, Viet Nam introduced a *National Strategy for the Fight Against Corruption Towards 2020*. The strategy mainly focuses on increasing transparency of policies, budgets and information about the operation of the government, as well as strengthening anti-corruption agencies and their power to investigate corruption. A revised Anti-Corruption Law, adopted in 2012, strengthens public transparency rules and criminalizes attempted corruption, passive and active bribery, extortion, bribing a foreign official, and money laundering. Evidence from the surveys cited above suggests that anti-corruption reforms have not yet had a major impact in practice.[6] A central Steering Committee on Anti-corruption, established in the Politburo and headed by the General Secretary of the Communist Party of Viet Nam, directs and coordinates state activities in this field throughout the country.[7]

2. General efforts to prevent corruption involving the private sector

As just mentioned, Viet Nam has taken several steps to establish the legal structures and public outreach needed to combat corruption in the private sector. The Government Inspectorate has been the main anti-corruption institution in Viet Nam for years and also functions as the ombudsman, receiving complaints and reports from civil servants, businesses, and private individuals. The Inspectorate has responsibility for direct oversight of state institutions, a function that includes preventing and combating corruption. The Inspectorateis not an investigative or prosecutorial body, but it refers cases to law enforcement agencies for investigation and follow-up.[8] The revised Anti-Corruption Law of 2012 and related enactments provide for whistleblower protections, guaranteeing the legitimate rights and interests of those who denounce acts of corruption, and holding state agencies responsible for protecting whistleblowers.[9]

The Anti-Corruption Law also requires all ministries, sectors, and localities to develop specific regulations to encourage public participation in anti-corruption activities. As for initiatives focusing on corruption issues in the private sector, Viet Nam agreed to implement the Transparency Standards on Government Procurement adopted by APEC in 2004. Drafting and deliberation on a national anti-corruption strategy in 2008, followed by adoption of UNCAC in 2009 indicated that private sector corruption prevention was taking on a higher priority, but observers suggest that the near-exclusive focus on the public sector has shifted little in practice.[10]

The National Strategy[11] opens with a statement of urgency in the preamble: “Corruption has become a major obstacle for the success of DoiMoi process and the fighting force of the Party, threatening the survival of the regime.” The objectives of the strategy include both increasing the transparency of the investment environment in order to stimulate economic growth (para. 2.2.3), and enhancing the awareness and participation of civil society in efforts to combat corruption (para. 2.2.5). Several aspects of business policy and governance are addressed, including the strengthening of company accounting and auditing standards, along with improving tax compliance (paras.3.2, 4.2). The strategy also seeks to encourage participation by business associations in the development of policies and laws aimed at reducing corruption, in “implementing a healthy business culture free of corruption,” and in enforcing the rules against bribery and fraud in public procurement and other domains of government (paras.3.3, 5.4). The strategy also calls for the strengthening of penalties for corruption, as well as provision of immunity or sentence-mitigation for offenders who self-report or take corrective action (para. 4.3). The Ministry of Justice is to take the leading in implementing changes along these lines agreed by the central steering committee.

One part of the strategy that appears to have been followed up is its commitment to reduce corruption in public procurement (para. 3.4) through increased transparency and restructuring of bidding and auction mechanisms. Concerns about corruption in procurement have centered on construction projects. In response, Viet Nam has joined the Construction Sector Transparency Initiative (CoST) pilot program to enhance accountability and transparency within that sector. CoST is a voluntary multi-stakeholder initiative focusing specifically on public disclosure of information. The ultimate aim is to enhance the accountability of procuring bodies and construction companies for the cost and quality of public-sector construction projects. A related field of reform is that of management and restructuring of state-owned enterprises. A draft decree for implementation in 2013 aimed to ensure that SOEs are fully transparent and regularly release relevant information, including total debts, bank loans and details of existing and upcoming projects.[12]

The Viet Nam Chamber of Commerce and Industry (the VCCI) is currently developing a project on “Promoting integrity in business activities.” The program aims at preventing corruption and conflicts of interest in the operation of enterprises in three ways: (i) Developing model codes of conduct for business activities; (ii) Supporting collective action in the business community in the form of integrity pacts by sector, locality and region; and (iii) Promoting policy dialogue between state authorities and the business community to create a competitive corruption-free environment.[13]

International standard[14]	Compliance by member country
Promote public-private cooperation to prevent private sector corruption (UNCAC 12(2)(a)).	National Strategy and Anti-Corruption Law provide for public-private cooperation. In 2006, Viet Nam cooperated with the government of Australia on a workshop to introduce the APEC code of conduct for the business sector to the community of SMEs in Viet Nam.
Encourage self-reporting and self-help by companies: 1) Provide official channels, guidelines, or assistance for self-reporting of corruption offenses. 2) Sentence mitigation for self-reporting, effective response to suspected corruption, preventive measures.	1) Government Inspectorate provides ombudsman function, including channel for corruption reports and complaints. 2) Sentence-mitigation and related incentives have not been available but are proposed in the National Strategy.
Public-private sector cooperation: 1) To enhance corruption prevention, detection, and reporting, e.g. partnerships in vulnerable sectors 2) To increase awareness of ethics standards and compliance procedures by companies and the professions e.g. seminars or disseminating guidelines. 3) To improve standards of corporate governance and ethical commercial practices.	1) National Strategy and Anti-Corruption Law provide basis for partnerships. CoST pilot program is designed to foster joint oversight in construction sector. 2) Pursuant to APEC, the Ministry of Planning and Investment in 2011 cooperated with the US Government to organize a workshop on “Business ethics in the construction and mechanical sector,” in order to develop a Code for SMEs operating in the construction sector in Viet Nam and APEC region. 3) National Strategy and Ministry of Finance corporate governance standards promote ethics norms and internal compliance procedures.
Encourage public commitments – e.g. *integrity pacts* – by businesses and private sector associations to strengthen transparency in accounting, improve corporate governance, and prevent corruption.	Integrity pacts have not been commonly used, but the CoST pilot program is demonstrating a mechanism of this kind in the construction sector. Similar approaches are proposed in the VCCI program.

3. Internal controls

The framework for corporate governance in Viet Nam is evolving. In 2007, the Ministry of Finance (MOF) adopted the Corporate Governance Regulations, primarily addressed to listed companies. Updated standards were issued in a 2012 Circular, applicable to all public companies. The purpose of the Circular is to implement "the best international practice on corporate management suitable to the conditions of Viet Nam to ensure a stable development of stock market and a transparent economy in Viet Nam." Public companies are obliged to follow the recommendations and to adopt their own written corporate governance code. Viet Nam has not adopted a general code of ethics applicable to Vietnamese companies. However, certain specific types of companies (such as insurance and securities companies) are required to adopt professional ethics rules. A review led by the IFC concluded in 2012 that "the companies themselves are not playing their part in developing a quality market for investment in Viet Nam." In other words, the regulatory frameworks and corporate governance standards are improving, but companies do not have a good record of compliance. Corporate governance developments in Viet Nam are described in the review as "top-down," led by legal-regulatory enactments, while the market waits for companies to become aware and take on their responsibilities.[15]

A. Internal audit

Viet Nam has adopted internal audit requirements, although there is no organized national profession or branch of the IIA. The Independent Audit Law[16] (art.57(2)) requires public interest entities to establish internal audit to safeguard assets, to assess the quality of information on financial management, to ensure legal compliance, and related matters. Public interest entities (art.53) include financial institutions, public companies, listed companies (issuers), securities trading firms, and potentially others. The Law took effect at the beginning of 2012, with some provisions taking full effect only after two or three years of that date. The IFC (2012: 84) reports that few Vietnamese companies have established an internal audit function, or have an internal auditor test and evaluate internal controls. Banks more frequently have such controls, as do leading companies with direct investment from countries where they are required or considered standard practice.[17]For companies not required to have internal audit, aspects of this function appear to be covered in part by the provisions, discussed below, on control boards and internal control systems.

International standard	Compliance by member country
Companies have sufficient internal auditing controls to assist in preventing and detecting corruption. (UNCAC 12(2)(f)).	Controls have been adopted, although research suggests companies lag in compliance.
Professional standards for internal auditors: 1) Defined by law or by membership in a professional association. 2) Include a duty to prevent and detect "illegal acts" in the books and records of companies, including bribery and other forms of corruption.	1) and 2): No professional body or standards.
Requirements for conduct of internal audit: 1) Basic audit to review financial statements, asset control, accounting for income and expenditure. 2) Risk-based system audit to review financial, operational and management control systems. 3) Review of legality of transactions and of safeguards against fraud, conflict of interest, corruption. 4) Internal auditor reports directly to the board of directors or audit/supervision committee.	1) Per Audit Law, internal audit required of public interest entities. Requirement includes safeguarding assets and monitoring financial information. 2) No explicit requirement. 3) Per Audit Law, internal audit of public interest entities to review legal compliance. 4) No provision.

B. Audit committee

Viet Nam's corporate governance provisions establish a structure having some key characteristics of audit committees. The structure is referred to as the Control Board. The Law on Enterprises[18] (arts.46, 95) requires any limited liability or shareholding company with more than 11 members to establish a control board – and permits companies under the threshold to establish one. For an LLC, the powers, responsibilities, and regulations of the control board are to be spelled out in a committee charter. For a shareholding company, a control board is also required if organizations own more than 50% of total shares.

For companies with 11 members or fewer, the Law (art.71) requires appointment of one to three persons who serve in lieu of a control board ("controllers")for a term of up to three years. The controllers have the same essential role as the Control Boards in larger companies, i.e. combining functions of auditor and audit committee (see below). They supervise management and business operations, evaluate and submit financial statements and reports on company management, and propose necessary changes to management structure and practices. Controllers have the right to demand the information required for their function, and they must not be related to managers or persons in the members' council (the governing body representing owners).

The structure, rights, and duties of a control board (Enterprise Law, arts.121-127) are similar to those of individual controllers but more substantial. The control board sits for renewable terms of up to five years, and is to have three to five members (unless the charter provides otherwise), at least one being an accountant or auditor. Members may not be managers of the company or managers' family members (or family members of directors), and need not be shareholders or employees. The control board may use consultants for its work. The control board's duties include the following:

- Supervise the management (Board of Management) including the managing or general director and report to the AGM. This includes monitoring the legality and prudence of business management and administration, along with accounting and preparation of financial statements.
- Evaluate and submit to the AGM reports on business, books of account, financial statements, and evaluation of the management of the Board of Management.
- Recommend to the Board of Management or the AGM changes and improvements of the organizational structure, management and administration of the business operations of the company.
- Carry out special control reviews at the request of shareholders, and report to the Board of Management any violation of management duties under the Law by Board of Management members or directors, directing the one in breach to cease and take remedial measures.

The control board has the right to timely receipt of reports and notices, and must be given access to all files relating to the management and operation of the company. Dismissal of members of the control board is limited to cases of breach of company charter, special AGM resolution, and voluntary resignation. Control board members may be held jointly and severally liable for breaches of ethics, duties, laws, and charter provisions that damage the company or third parties.

The revised standards on Corporate Governance, contained in Ministry of Finance Circular No. 121/2012/TT-BTC,[19]provide some further specifications for the Control Boards required of all public companies. Commentary makes it evident that the public company control board is part of a two-tier board structure and is not a committee of the board of managers ("board of directors"). It is similar to, and performs the functions of, the regular Control Boards provided for in the Law on Enterprises. The board of directors has the option of establishing specialized committees – the ones suggested especially for large public companies or listed companies are committees on policy development, human resources, and remuneration and bonuses. These committees are pre-approved or "default" committees; additional ones can be stipulated by shareholder resolution (arts.11, 32).[20]

Thus, the controllers and control board stipulated in the Law on Enterprises are not committees of the board of directors, but rather combine the functions of audit (internal and external) with those of a supervisory board. Ministry of Finance Circular No. 121/2012/TT-BTC provides further differentiation, with the control board required to be wholly separate from the external auditor. The Circular (arts.17-21) reiterates the Law on Enterprises' provisions on membership, rights, and duties of the Control Board. The Circular adds some points that are absent or unclear in the Law. Thus, art.21.5 empowers the control board to nominate independent auditors or firms to audit the company's financial statements. Also, members of the control board, along with the board of directors and executive director and other managers, must disclose potential conflicts of interest and avoid self-dealing, while the company must not provide these officials with any loans or guarantees (arts.23, 28).[21]

International standard	Compliance by member country
1) Encourage or require companies to establish audit committees (or equivalent). 2) Committee members to include: • Financial experts. • Independent directors.	1) Law on Enterprises and Corporate Governance Circular require public companies and certain LLC and share companies to establish a control board with powers similar to audit committees. Other companies to appoint individual controllers. 2) Control board to have 3-5 members who meet objectivity criteria (but not required to be independent directors), including one accountant or auditor.
Audit committee terms of reference: 1) Supervise accounting methods, internal and external audit. 2) Review internal controls and ethics code, compliance of directors, managers, employees, and agents. 3) Guidance to staff on compliance and on preventing corruption. 4) Respond effectively to information on possible corruption. 5) Provide confidential channel of communication for reports of suspected irregularities, corruption.	Per Law on Enterprises and MOF Circular on Corporate Governance: 1) Control board to supervise accounting and nominate external auditor (public interest entities). 2) Control board to monitor management, including legal compliance and prudent decision-making. 3) No provision. 4) Control board to report internally on any violation of norms and duties by management. 5) No provision.

C. Internal control and compliance systems

The Independent Audit Law (art.57(1)) requires public interest entities to "construct and operate internal control systems appropriately and effectively." As mentioned above, this category is defined in detail to include public and listed companies, financial institutions, insurers, stock issuers and traders, and others.

The Law on Enterprises mentions internal governance several times, for example in art.12(1) requiring companies to keep documentation on their internal management rules. These are not spelled out, apart from basic internal structural features such as allocation of decision making authority and reporting relationships. The Corporate Governance Circular (art.31) takes a step further, spelling out mandatory internal rules for large-scale public companies (not defined in the regulation). Most of the rules deal with procedures for meetings, but two provisions seem to relate to internal control:

- Procedures for cooperation between the control board, the board of directors, and executive director.
- Provisions on annual assessment, recognition and disciplinary action applicable to members of the board of directors, control board, executive director, and other managers.

The board of directors is responsible for preparing these rules and announcing them on the company website. This appears to be the extent of the provisions on internal governance – apart from the control board's oversight – and there are no general requirements for ethics codes or risk management systems. Last, the CG Regulations (art.37) state that administrative, civil, and criminal sanctions can be applied to violations of the Regulations, but these are not spelled out.

International standard	Compliance by member country
Procedural requirements: 1) Companies to disclose internal control systems publicly, or justify their absence. Disclosure includes explaining problems of implementation. 2) Internal controls on financial reporting: management (or audit committee) assesses; external auditor tests. 3) Commitment and support across the company: • Senior management to signal company-wide support for all components. • Written undertakings and training on compliance required of all directors, officers, employees. 4) Risk-based approach: • Individualized assessment of	1) Per Audit Law, public interest entities to establish internal controls. Per Corporate Governance Circular, large-scale company to publish internal rules on its website. 2) Per Corporate Governance Circular, control board oversees financial reporting systems. 3) and 4): No provision.

risks to the enterprise, including corruption risks. • Regular monitoring and re-assessment of corruption risks.	
Substantive components: 1) Require adherence to all applicable laws and standards on behavior that may affect the integrity of financial statements. 2) Clearly prohibit bribery and other forms of corruption, and strongly discourage actions that contravene good commercial practice. 3) Provide guidance in such sensitive areas as gifts, entertainment, political contributions, charitable donations. 4) Require for third-party representatives, consultants, or agents: • Written contract, adherence to company ethics standards and anti-corruption laws. • Oversight, including independent audit. • Compliance with public disclosure rules on agent transactions with government.	1) Per Corporate Governance Circular, control board monitors legal compliance and standards of good business conduct. 2) through 4): No provision.
Enforcement, including sanctions for failure to comply.	Sanctions for violation of Corporate Governance Circular are mentioned but not spelled out, as also for violations of relevant Audit Law rules.

4. Integrity of financial statements

A. Accounting

1. Financial records

The Law on Enterprises (art.12) requires companies to retain such documents as books of account, accounting records, financial statements, and papers certifying ownership of assets. The Law on Accounting (art.40(5)) stipulates a retention period of at least five years for accounting records used for the accounting units' management and administration work, and at least ten years for accounting vouchers directly used for entries in accounting books and financial statements.[22] The Independent Audit Law (art.50) further requires the archiving of audit records for at least ten years.[23] That law also prohibits falsification of records, books, and reports by auditors, officials of audited companies, and others involved in the audit (arts.13, 19, 30). The Law on Enterprises (art.11) prohibits falsification and improper alteration of business registration documents. The Accounting Law (art.14(4)) prohibits destroying or deliberately damaging accounting records before the end of the retention period, and also prohibits deliberate falsification of records, non-recording of assets, and related manipulations.

International standard	Compliance by member country
Record-keeping requirements: form, method, and minimum time period for retention of financial records.	Per Enterprise Law, accounting and related documents to be kept. Per Accounting Law, retention period of 10 years for key records, 5 years for others. Per Audit Law, audit records to be kept for 10 years.
Prohibitions (UNCAC 12(3), OECD Convention 8(1)), OECD Recommendation X(A)(i))): 1) The use of false documents. 2) The intentional destruction of bookkeeping documents earlier than foreseen by law. 3) Establishing off-the-books accounts. 4) Making off-the-books or inadequately identified transactions. 5) Recording non-existent expenditure. 6) Entry of liabilities with incorrect identification of their objects.	1) Per Audit Law: Falsification of records, books, reports by auditors or audited companies prohibited. 2) Accounting Law prohibits early destruction or damage. 3) through 6): Accounting Law prohibits misleading entries and omissions.

2. *Financial reporting requirements*

Under the Accounting Law, all companies are required to prepare and present financial statements in accordance with Vietnamese Accounting Standards (VAS).[24] Financial statements must comply with VAS no. 21 ("Presentation of financial statements"), which requires them to be "honest and reasonable," to reflect accounting policies ensuring that the information provided is reliable and economically relevant,[25] and to be based on the figures as of the closing of the books of account. The financial statements must be signed by the person preparing the statements, the chief accountants and legal representative of the accounting units, and sealed with the seals of the units.

The Law on Enterprises accords the right to the AGM in the case of shareholding companies (art.96) and members' councils in the case of LLCs (art.47) to approve annual financial statements. The Law also requires shareholding companies (arts.128-9) to prepare annual financial statements, have them approved by their AGM, and submit them to the relevant state bodies. All shareholders must be sent a summary of the statement, and the full financial report is to be made available for public scrutiny at the registry. Parent companies (defined as holding 50% of equity, or having the right to make key appointments or amendments to the charter) must prepare integrated (consolidated) financial statements for the group (art.148).

Viet Nam uses its own national standards, based on International Financial Reporting Standards (IFRS). The Accounting Law endorses the alignment of VAS with IFRS, and the government states that VAS "are developed on the basis of learning and selecting" from the IFRS. Accordingly, all businesses in Viet Nam must prepare and present their financial reports in compliance with the Accounting Standards and Business Accounting Regime stipulated in the regulations applicable to businesses generally and to SMEs.[26] Currently, certain businesses use IFRS rather than VAS to prepare financial statements. These are primarily companies with foreign investors along with some commercial banks and non-governmental organizations. Efforts are being made to implement IFRS more widely. This includes translating updated IFRS, circulating them, incorporating them in college curricula, and raising awareness.[27]

International standard	Compliance by member country
Accounting and financial reporting: 1) Companies required to use International Financial Reporting Standards (IFRS) or more stringent rules. 2) Modified requirements for SMEs. 3) Disclosures must include liabilities of affiliated companies, off-balance sheet transactions, and special-purpose entities.	1) Per Accounting and Enterprise Laws: All companies required to prepare financial statements. Shareholding companies must submit them to regulators and make them publicly available. VAS are based on IFRS (earlier version). 2) Special provisions for SMEs. 3) Consolidated reporting required for subsidiaries. Other items would require inclusion if IFRS 10 applies, but it is not in the available list of VAS.
1) Companies required to disclose all material contingent liabilities, including losses likely to result from prosecution of the company or its agents for bribery. 2) Companies prohibited from disguising illegal or corrupt transactions in financial records (OECD Convention 8(1)).	1) Such disclosure addressed in IAS 37, which appears to be incorporated in VAS. The relevant provision of VAS could be applied to potential corruption-related liabilities, but this issue has not yet been decided.[28] 2) This falls generally within Accounting Law art. 14, cited above, although it is not specifically outlawed.

B. Audit

1. Auditing requirements

Under the Accounting Law, all companies are required to prepare and present financial statements audited in accordance with Viet Nam Standards of Auditing (VSA). The Law on Independent Audit (art.6) provides that the Ministry of Finance issues auditing standards (along with professional ethics standards for accountants and auditors) on the basis of international standards. Up to 2006, the MOF promulgated 37 VSA directly translated from the International Standards on Auditing (ISA).[29] Based on the analysis above, most business audit functions are not legally required to be independent professional audits, but may be performed by controllers and control boards as provided in the Law on Enterprises.

Stricter standards apply to the organizations identified in the Law on Independent Audit. As discussed above, that Law creates a category of public interest entities including financial institutions, public companies, listed companies (issuers), securities trading firms, and potentially others (art.53). Audits of these entities are to be performed by “auditing firms, branches of foreign auditing firms in Viet Nam” that are selected according to standards set by the MOF and approved by the relevant state registration and regulatory agencies (art.54). A separate provision (art.37) requires certain companies to be audited by “foreign auditing firms, branches of foreign auditing firms in Viet Nam.” The category of “audited units” listed here appears broader than the above list and includes, in addition, enterprises with foreign investment, most SOEs, organizations implementing certain state-funded projects of national importance, entities with state funding or capital, and auditing firms (besides the requirement of independent audit, some of these may be audited by the State Auditor). These “audited units” are subject to compulsory audit, which requires attaching the audit reports to financial statements submitted to state agencies and the publication of these documents (art.9).

The Independent Audit Law also spells out aspects of the audit process and the rights and obligations of the parties. Thus, auditors and their audit firms (arts.17, 28) may request any information, documents, and explanations that they need for the audit, including inventories of assets, and are entitled to inspect all records and documents when and where necessary. They may also request the same of “concerned organizations and individuals,” i.e. third parties. The audited entities have the corresponding duty to supply all the information, explanations, records, etc. needed for the audit, and are held responsible for their content (art.39). The entities must coordinate with the auditors and avoid creating obstacles to their work. Audited companies are strictly prohibited from refusing cooperation with the auditor, obstructing the audit, providing false or incomplete information, concealing legal violations, and bribing or colluding with auditors or others in falsifying records or statements (art.13). The auditor’s report must outline the objectives, scope, and process of the audit, and provide an opinion on the financial statements, and this must include matters to be determined by the MOF (arts.46, 48). The responsible audit professional must sign the audit report.

International standard	Compliance by member country
Private enterprises must have sufficient auditing controls to prevent and detect corruption (UNCAC 12 (2)(f)).	The controls are well-developed, but it is not clear if they are in practice adequate for the purpose or not.
1) Requirement that companies have accounts regularly audited and published (UNCAC 12 (2)(f)). 2) Modified requirements for SMEs.	Per Enterprise and Audit Laws: 1) All companies to have accounts audited annually, but only public interest entities and other designated “audit units” to have audits done by approved or international audit firms. 2) Most companies may be audited by their controllers / control boards.
Companies required to use International Standards of Audit (ISA), including ISA 240 and ISA 250 or more stringent rules.	Vietnamese standards are based on ISAs, which appear to include versions of ISA 240 and 250.
Other requirements: 1) External auditor shall: • Certify that the financial statements fairly represent the financial position of a company. • Provide an opinion on the way in which financial statements have been prepared and presented. • Describe the procedures for testing the internal control systems and identify the components of the systems that pose risks. 2) Company obligations: • Certification of financial reports by Chief Executive Officer and/or Chief Financial Officer. • Prohibition against corporate officers and directors misleading the external auditor.	Per Audit Law: 1) Audit report to include auditor’s opinion on the financial statements. The required content of the opinion is provided in a separate rule by the MOF. 2) Chief accountants are required to sign the financial statements. Audited entities are responsible for the content of materials provided to the auditor, and are required to cooperate and provide all necessary information, documents, explanations. Obstructing, falsifying or concealing information, and bribing or colluding with auditor to do so are prohibited.

2. *Auditor reporting of improprieties*

Viet Nam does not appear to impose any explicit legal duty on external auditors to report improprieties either internally to the company or to outside authorities – apart from what is required by the VSA. Since the latter are reported to be translated from the ISA (though not the most current one), and have legal force under the Audit Law, it follows that external auditors are required by the standards to report fraud and other illegalities to management as stipulated in ISA 240 and 250. This provision is reaffirmed in the Independent Audit Law (art.29) requirement that auditors[30] bring legal violations to the attention of the audited entity. While ISA 240 and 250 also contemplate reporting such irregularities to external authorities, this would be required only where legal duties and protections are in place. In Viet Nam, this is not the case. The Audit Law (art.43) in fact includes a strong statement of the auditor's duty of confidentiality, prohibiting any disclosures unless endorsed by the client or prescribed by law. While external reporting is not allowed *per* se, financial statements and audit reports are disclosed. The Enterprise and Audit Laws require shareholding companies and public interest entities to submit financial statements to their shareholders and regulatory agencies, and in some cases to make them public, along with the audit report (Enterprise Law arts.128-9, Audit Law art.9).

International standard	Compliance by member country
Internal reporting: External auditor who discovers indications of bribery or other corruption must report this to management and to board of directors or audit committee.	Internal reporting required by VSA equivalent of ISA 240 and 250, and by Audit Law
External reporting: 1) Duty to report suspected corruption to competent authorities. 2) Legal basis that permits reporting suspected corruption to outside authorities, and protection from legal action for auditors acting in good faith ("safe harbor").	1) and 2): ISA 240 and 250 contemplate external reporting, but only if provided by law. Audit Law requires protection of confidentiality and does not provide for external reporting.

C. Professional standards and independence

The Independent Audit Law (arts.11-12) makes the Ministry of Finance responsible for organizing and supervising the accounting and auditing profession. It sets the standards, training requirements, conditions for examination and licensing, and systems for registering and regulating audit firms. The Ministry also has authority for quality control monitoring and inspection, handling rule violations and complaints, and suspending practices of individuals and firms. The Law provides for professional organizations to take on some of these regulatory responsibilities, along with professional development and training.

The Viet Nam Association of Accountants and Auditors (VAA) is an umbrella organization including professional organizations of accounting and auditing professionals, notably the Viet Nam Association of Certified Public Accountants (VACPA). VAA and its members perform several of the functions allocated under the Audit Law to the MOF, including registering professionals and firms, monitoring professional practice, and organizing courses for continuing education. The Ministry plans to transfer responsibilities for administering the accounting and audit profession to VAA in stages over time. Thus, in 2007, the MOF transferred direct administration of professional quality assurance and quality control to VAA, which has established a unit for monitoring and inspection. The Ministry in 2005 promulgated a professional ethics code based on the IFAC/IESBA Code then current, and has since adopted regulations to monitor and enforce the code.[31]

The Audit Law specifies the key requirements and conduct norms for audit professionals. Auditors must meet the basic qualifications and have three years' experience, in order to obtain the necessary certificate for professional practice (art.15). Practicing auditors and firms are subject to several professional rules and obligations laid out in the Law (arts.18, 29). These include:

- Ensuring the auditor and firm's independence, which may require the refusal of assignments where professional independence may be threatened, or other conditions or obligations exist that are contrary to professional and ethical standards or to legal-regulatory obligations.
- Complying with requirements to report audit activities to the Ministry or other agency, to submit to inspection and quality control of audit services, and to provide audit records and other documents as requested by the relevant state agencies.
- Notifying the audited company when the auditor or firm finds evidence of non-compliance with laws on accounting, audit, finance, or corporate governance.

The Independent Audit Law (art.52) also provides for the Ministry's exercise of audit quality control, for which it is empowered to adopt regulations, set up a professional council, and contract auditors and other experts. The MOF is also responsible for adopting any special standards, selection criteria, and review processes for firms that wish to audit public interest entities (art.54). These audit firms have stronger disclosure requirements, including an obligation to post specified information on their websites and to submit annual transparency reports to the Ministry (arts.55-56)

Detailed provisions on auditor independence and objectivity are included in the Independent Audit Law. Audit firms must rotate the professionals who sign audit statements for a client after three years, and rotate all practicing auditors on a public interest unit assignment after five years (arts.39, 58). A list of actions is "strictly banned" (art.13), including the holding of any shares in the audited unit, and in some cases bonds or other assets; receiving any benefits from the client company other than those agreed in the audit contract; falsifying audit records or colluding with the client to falsify financial statements or records; and individuals engaging in solo audit practice or working for more than one audit firm. In addition, auditors and firms are not permitted to conduct an external audit where an auditor (or firm manager):

- holds a managerial or accounting/control board position with the client or has done so within the last two years;
- in the preceding year has prepared the books or financial statements or conducted internal audits, or other service that may compromise the auditor's independence; or
- has a family member with financial interests in the audited entity (arts.19, 30).

An audit is also not permitted where the audited entity was involved in the establishment of the audit firm. Lastly, the Law (art.27) specifies conditions on which the practice certificate of an audit firm may be suspended or terminated, which include serious violations of professional or technical standards (suspension), and falsifying the application for the professional certificate or deliberately certifying a financial statement with material misstatements (termination).

International standard	Compliance by member country
Accountants: 1) Standards for qualification and licensing, institution for oversight and discipline. 2) Professional code of conduct, e.g. IFAC Code.	1) Standards for qualification and quality control set by MOF. 2) MOF adopted a version of IFAC/IESBA Code.
Auditors: Rules to ensure independence and objectivity of companies' external auditors. 1) Appointment procedure. 2) External auditors' involvement in non-audit work for client firms. 3) Periodic auditor rotation. 4) Auditors' interests in audited firms. 5) Companies' employment of former auditors.	1) Per MOF Circular No. 121/2012/TT-BTC, control board nominates external auditors. Per Audit Law, audits must be done by "audit firms, branches of foreign audit firms in Viet Nam"[32] contracted by the audited company. 2) Per Audit Law: Certain non-audit work including accounting and internal audit prohibited, also any benefit not in contract. 3) Per Audit Law: rotation of signing auditor every 3 years, other auditors every 5 years. 4) Per Audit Law: No financial interest by auditor or family, and no management or accounting/control board post. 5) No provision.
Auditors: Professional standards and oversight. 1) Registration, qualification, and licensing requirements. 2) Requirements for ongoing training on audit and ethical standards. 3) Independent professional body supervises audit professionals' performance and audit quality control environments. 4) Professional discipline including sanctions for rule violations.	1) and 2): Per Audit Law: Registration, qualification, continuing education standards set by MOF. 3) MOF is the state authority governing the profession, per Audit Law. MOF may delegate functions to professional associations under the Law, and is handing some functions to VAA. 4) Audit Law specifies sanctions for rule violations.

D. Enforcement

Sanctions for failure to comply with financial reporting and auditing rules are mainly set forth in the Independent Audit Law, but other enactments touch on this also.[33]The Law on Enterprises contains a general provision on breaches of the Law (art.165), which states that these are subject to disciplinary action, administrative penalty or criminal prosecution depending on the seriousness of the offense. Violators must also compensate for damage caused to the interests of an enterprise, its owner, members, shareholders, or third parties such as creditors. The MOF Circular No. 121/2012/TT-BTC (art.37) includes the same clause addressing violations of its provisions.

The Law on Independent Audit contains sanctions provisions, most of them focusing on auditors and their firms. As indicated above, the Law (art.27) specifies conditions for the suspension or termination of an audit firm's practice certificate, such as serious violations of professional or technical standards (suspension), and deliberately certifying a financial statement with material misstatements (termination). The Law also requires audit firms to pay compensation for damages to clients, consistent with their audit contracts (art.29). The Law provides for warnings, fines, suspension or revocation of audit practice certificates, and civil or criminal liability for various breaches of the Law's rules (arts.59, 60). The violations include providing audit services without a valid certificate, breach of MOF regulations on inspection and quality control, performance of prohibited acts (art.13), breach of independence (conflict of interest) standards, negligent or intentional falsification or manipulation of statements or documents, and others.

International standard	**Compliance by member country**
1) Accounting rules and procedures are fully used to combat bribery and prevent hiding of bribery (OECD Convention 8(1). 2) Laws and procedures on external audit are fully used to combat bribery, other forms of corruption (UNCAC 12 (2)(f), OECD Recommendation X(B)(i)).	1) and 2): It is not clear whether accounting and audit rules are either strict enough or sufficiently well enforced for this purpose.
Effective, proportionate and dissuasive penalties for failure to comply with *accounting* standards (UNCAC 12(1), OECD Convention 8(2)): 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Sanctions provisions are broad and include administrative penalties such as withdrawal of certificate, as well as civil and criminal penalties. 2) Penal provisions of Law on Enterprises and Circular No. 121/2012/TT-BTC apply in part to companies, as do a few of the sanctions in the Audit Law. 3) Enforcement options include MOF, VAA, regulators, and courts. Effectiveness not clear.
Effective, proportionate and dissuasive penalties for failure to comply with *audit* standards: 1) Range of sanctions. 2) Penalties apply to the companies themselves as well as management, directors, accountants and auditors. 3) Effective enforcement mechanisms.	1) Sanctions provisions are broad and include administrative penalties such as withdrawal of certificate, as well as civil and criminal penalties. 2) Penal provisions of Law on Enterprises and Corporate Governance Circular apply in part to companies, as do a few of the sanctions in the Audit Law. 3) Enforcement options include MOF, VAA, regulators, and courts. Effectiveness not clear.

5. Conclusion and recommendations

A. General efforts to prevent corruption involving the private sector

To date, Viet Nam's corruption problems have grown while the focus of its efforts to combat it has been on the public sector, with less attention to the private sector. The Government Inspectorate has provided a channel for complaints and reports, while the 2012 Anti-Corruption Law aims to stimulate public participation in the fight against corruption and to protect whistleblowers. The National Strategy attempts to shift the focus much more to the private sector, dealing with financial reporting and ethics codes. Viet Nam's entry into an international pilot program to reduce corruption in procurement contracting is also a positive development.

Recommendations

1) Strengthen the focus on prevention of private sector corruption, building on the National Strategy and on more recent developments such as the Corporate Governance Regulations. Anti-corruption instruments and agencies could usefully coordinate to a much greater extent with institutions dealing with corporate governance such as the SSC, Ministry of Finance, VCCI, and VAA to strengthen accountability and safeguards in business.
2) Build on the CoST procurement pilot activity to create more robust integrity pacts dealing with construction, other fields of procurement, decentralized investment regulations, and other areas.

B. Internal controls

Observers have suggested that corporate governance reform in Viet Nam is "top-down," with government enacting reforms and private sector practice following behind, with some lag. In terms of internal audit and internal control systems, there are legal requirements applicable to certain categories of companies. The Independent Audit Law requires public interest entities to establish these functions, but provides little additional guidance. Compliance is reported to be uneven, with banks and foreign subsidiaries performing best. The laws and regulations applicable to companies do not provide for an audit committee as such. Rather, the basic requirement for smaller companies is to appoint controllers, who appear to perform a range of functions including audit (both internal and external). Companies above a threshold must establish a control board, which supervises management and attends to audit and control functions. Public interest entities, including publicly-owned companies and others, must have a separate control board that meets some additional criteria and is responsible for nominating external auditors and disclosing corporate governance issues such as potential conflicts of interest. Rules for board membership are provided, but no real safeguards of its independence.

Recommendations

1) Build more bottom-up or partnership dynamics into corporate governance reform. A more open environment for civil society would help here, as would linking corporate governance to broader efforts to combat corruption affecting the private sector, and conducting more regular outreach and training on the legal framework.
2) Strengthen internal audit and internal control systems by providing more guidance on how to implement them, disseminating the guidance through training and other interventions, and recognizing models of good practice. Support the development of communities and organizations of professionals in these areas, especially internal audit.
3) Enhance the independence of control boards for public interest entities by tightening the membership criteria to ensure less dependence on management and more financial expertise. Also, incorporate more specific guidance on mitigating corruption risk into the terms of reference of the control board as well as the internal audit and control functions.

C. Integrity of financial statements

Viet Nam’s financial reporting and auditing rules continue to evolve. IFRS and ISA have been incorporated into national standards, but work continues on updating and more comprehensive adoption. Document retention is addressed, with minimum periods set at five or ten years. Falsification of documents is prohibited in various forms, and off-the-books transactions and other manipulations appear to be outlawed by the terms of the legislation. All companies must prepare financial statements and have them audited, but in most cases the statements are not independently audited, filed with a regulator, or published. The requirements of the audit opinions are not stated in detail, but the companies are legally responsible for the content. Auditor reporting of fraud and corruption to management is required, but no reporting is permitted to external authorities. The accounting and audit profession is jointly governed by the Ministry of Finance and the VAA network, which carries out a growing list of delegated oversight and administrative functions. Sanctions for breach of standards and rules in this area are provided by law, but research suggests that compliance in several areas is weak – an indication that enforcement is not very strong.

Recommendations

1) Develop in more detail the provisions on the content of audit opinions, and adopt an explicit requirement of certification of financial statements by the CEO or CFO.
2) Adopt a requirement for auditors to report major fraud and corruption offenses to state authorities, along with a safe harbor provision protecting the auditor from liability.
3) Adopt stronger and more specifically-defined sanctions for financial reporting and auditing offenses, and tighten enforcement.

Viet Nam Laws, Regulations, Policy Documents Referenced:

Accounting Law No.03/2003/QH11 of June 2003, http://chinhphu.vn/portal/page/portal/English/legaldocuments/Policies?categoryId=886&articleId=10001391.

Law on Enterprises, No. 60-2005-QH11, 2006, http://www.vietnamlaws.com/freelaws/Lw60na29Nov05Enterprises%5B10Apr06%5D.pdf.

Law on Independent Audit, No.: 67/2011/QH1, http://www.itpc.gov.vn/investors/how_to_invest/law/Law%20No.67_2011_QH12/mldocument_view/?set_language=en

Law on Tender no.43/2013/QH13.

Ministry of Finance Circular No. 121/2012/TT-BTC *Prescribing Company Management (or "Corporate Governance") Applicable to Public Companies*, http://tienganhchuyennganhluat.wordpress.com/2013/11/06/no-1212012tt-btc-circular-prescribing-the-company-management-applicable-to-public-companies/

National Strategy for Preventing and Combating Corruption Towards 2020, September 2008 Draft, http://www.ngocentre.org.vn/webfm_send/20

NOTES

1 http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/vietnam/show-all.aspx; http://www.bti-project.org/reports/country-reports/aso/vnm/index.nc.

2 http://www.bti-project.org/reports/country-reports/aso/vnm/index.nc.

3 World Bank (2013), "Corruption from the Perspective of Citizens, Firms and Public Officials," Hanoi: National Political Publishing House (2nd ed.), http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2013/03/13/000333

037_20130313144107/Rendered/PDF/738070REVISED0000January02013000ENG.pdf.

[4] These surveys are part of the *Vietnam Provincial Competitive Index* (PCI) series. In the 2010 survey, some 34% of domestic enterprises reported paying commissions when participating in public procurement bids.

[5] http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/vietnam/show-all.aspx; http://www.bti-project.org/reports/country-reports/aso/vnm/index.nc.

[6] http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/vietnam/show-all.aspx; http://www.bti-project.org/reports/country-reports/aso/vnm/index.nc.

[7] Government comments citing Politburo Decision 162-QĐ/TW of Feb. 2013.

[8] Government comments citing Decree 83/2012/NĐ-CP dated 09/10/2012.

[9] Anti-corruption Law (Article 65); Law on Denunciations; Decree 59/2013/NĐ-CP dated 17/6/2013 (art.58) – as cited by government.

[10] http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/vietnam/show-all.aspx.

[11] National Strategy for Preventing and Combating Corruption Towards 2020, September 2008 Draft, http://www.ngocentre.org.vn/webfm_send/20.A final version does not appear to be available in translation

[12] http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/vietnam/show-all.aspx. Government further points out that other enactments indirectly aid the prevention of corruption involving the private sector, e.g. The Law on Enterprise, Law on Competition, Law on Trade, Law on Accounting, Law and Decree on Anti-Money Laundering, and Laws on Taxation.

[13] Government comments

[14] The sources of all standards are provided in footnotes to the tables presented in the section of the Review entitled *International Standards for Country Reports.*

[15] IFC and State Securities Commission of Vietnam (2010), *Corporate Governance Manual*, pp.77, 81, http://www.ifc.org/wps/wcm/connect/8a40ee804a81f904ad3dfdf998895a12/CG+manual+for+Vietnam-second+edition-Eng.pdf?MOD=AJPERES; IFC (2012), *Vietnam Corporate Governance Scorecard 2012*, IFC with Global Corporate Governance Forum and State Securities Commission of Vietnam, pp.22-23, http://www.ifc.org/wps/wcm/connect/4e9e9c804ddfdfd39ab2ba7a9dd66321/Scorecard+2012+-+Eng.pdf?MOD=AJPERES .

[16] Law on Independent Audit, No.: 67/2011/QH1, http://www.itpc.gov.vn/investors/how_to_invest/law/Law%20No.67_2011_QH12/mldocument_view/?set_language=en.

[17] Government notes that it has made repeated efforts to establish internal audit requirements, beginning in the 1990s with the SMEs. The legal provisions on internal audit are still evolving, and public companies are not as aware of the importance and methods of internal audit as they should be. As a result, internal audit has not yet been used effectively as an anti-corruption tool.

[18] Law on Enterprises, No. 60-2005-QH11, 2006, http://www.vietnamlaws.com/freelaws/Lw60na29Nov05Enterprises%5B10Apr06%5D.pdf.

[19] Ministry of Finance Circular No. 121/2012/TT-BTC *Prescribing Company Management (or "Corporate Governance") Applicable to Public Companies*, http://tienganhchuyennganhluat.wordpress.com/2013/11/06/no-1212012tt-btc-circular-prescribing-the-company-management-applicable-to-public-companies/.

[20] http://www.jurists.co.jp/en/publication/tractate/docs/cg2013_vietnam.pdf.

[21] In addition, the Circular stipulates the required information that the Control Board must present in its report to the annual General Meeting of Shareholders (art.8).

[22] Accounting Law No.03/2003/QH11 of June 2003, http://chinhphu.vn/portal/page/portal/English/legaldocuments/Policies?categoryId=886&articleId=10001391.

[23] Art.50, along with Decree 17/2012/NĐ-CP dated 13/3/2012, make this the responsibility of the legal representatives of the auditing firms and branches of foreign auditing firms in Vietnam.

[24] Action Plan developed by Vietnam Association of Accountants and Auditors (VAA), p.3, http://www.ifac.org/sites/default/files/compliance-assessment/part_3/201211VietnamVAA.pdf.

[25] I.e. the statements fairly represent the enterprise's results and position, reflect the economic substance of events and transactions, and are neutral, prudent, and complete in all material respects.

[26] Decision 15/2006/QĐ-BTC and Decision 48/2006/QĐ-BTC respectively; government comments.

[27] VAA Action Plan, pp.3, 9, 15.

[28] Government points out that VAS No. 18 prescribes "accounting policies and procedures in relation to provisions, contingent liabilities and contingent assets in terms of Recognition, Measurement, Reimbursements, Changes in Provisions, Use of Provisions, and Application of the Recognition and Measurement Rules as a basis for the presentation and disclosure of financial statements." As applied in most other countries, the relevant provision of the IFRS (IAS 37) does not *require* the disclosure of corruption-related contingent liabilities in most circumstances.

[29] VAA Action Plan, p.9.World Bank (2006), *Report on the Observance of Standards and Codes (ROSC): Corporate Governance – Country Assessment, Vietnam*, p.24, http://www.worldbank.org/ifa/rosc_cg_vm.pdf.

[30] The Law applies this duty to the audit firms rather than individual members. The effect is similar to an individual ethical duty, but the reporting burden is placed on the firm, which is legally responsible for the audit.

[31] VAA Action Plan, pp.3-6, 11-14.

[32] I.e. either a domestic audit firm or a branch of a foreign audit firm.

[33] Notably, Decree 105/2013/NĐ-CP dated 16/9/2013 of the Government stipulating administrative sanctions for violations in the areas of accounting and auditing.

The ADB/OECD Anti-Corruption Initiative for Asia and the Pacific

Corporate Measures to Prevent and Detect Corruption in Asia and the Pacific

This Thematic Review surveys the frameworks and practices of the members of the ADB/OECD Anti-Corruption Initiative for Asia and the Pacific in areas related to the prevention of corruption involving the private sector. Specifically, the Review covers implementation of the provisions on private sector-related corruption contained in the UN Convention against Corruption and the OECD Anti-Bribery Convention. These include measures to adopt and enforce accounting and auditing standards in the private sector, promote state-private cooperation; develop standards of good corporate governance, ethical business practice, and integrity in the accounting and audit professions; ensure that businesses have sufficient audit and internal controls to prevent and detect corruption; and prohibit the concealment of fraud and corruption in accounts and financial records. The Review also identifies trends and challenges across the Asia-Pacific region.

The ADB/OECD Anti-Corruption Initiative for Asia and the Pacific supports its 31 member countries and jurisdictions in their efforts to establish sustainable safeguards against corruption as set out in the Anti-Corruption Action Plan for Asia and the Pacific. For more information, please visit **www.oecd.org/site/adboecdanti-corruptioninitiative.**