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**NBA Practice Note 1137**

**Corruption, procedures of the auditor**

December 22, 2016

Koninklijke Nederlandse  
Beroepsorganisatie  
van Accountants

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The Dutch version is leading when discussions take place how to interpret the document.

## NBA Practice Note 1137 - Corruption, procedures of the auditor

NBA Practice Note 1137:	<b>Corruption, procedures of the auditor</b>
Applicable for:	Auditors (auditors in public practice, internal auditors and public sector auditors) who perform audit engagements on financial statements. This Practice Note can also be used, adapted where necessary, by accountants who perform audit engagements on other items, review engagements, assurance engagements, compilation engagements or other engagements.
Subject:	Corruption
Date:	22 December 2016
Status:	NBA memo, not mandatory provision. When the text uses the word 'should' or any synonym, then it is understood to refer to a legal or other obligation.
Relevant regulations:	<ul style="list-style-type: none"><li>• Anti-Bribery Convention (OECD);</li><li>• Dutch Criminal Code;</li><li>• US Foreign Corrupt Practices Act (US FCPA); and</li><li>• UK Bribery Act</li></ul>
	General: UK English is used

## Corruption, procedures of the auditor

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# 1 Introduction

## 1.1 Rationale/trigger

Efforts to combat corruption have led to initiatives including the worldwide Anti-Bribery Convention (*Convention on Combating Bribery of Foreign Public Officials in International Business Transactions*). This Convention was concluded via the Organisation for Economic Co-operation and Development (OECD).<sup>1</sup> Dutch legislation has been tightened on the basis of this Convention since 2001 (including [Article 177](#) of the Dutch Criminal Code). Dutch entities also have to deal increasingly with extraterritorial legislation, such as the American [Corrupt Practices Act \(US FCPA\) US Foreign](#) and the British [UK Bribery Act](#). Public opinion of corruption has also changed: society has become more critical with respect to corruption.

Corruption relates to acts that involve giving a gift or making a promise in order to persuade the other party (like an official or a private-law party) to do or refrain from doing something. So called 'facilitating payments' relate to cash payments of smaller amounts that are used to expedite acts. Also, corruption often relates to conflict-of-interest issues (i.e. the mixing of private and business interests).

The following forms of corruption often occur in practice:

- Kickback payments to persons in their private capacity, including as part of a procurement process;
- Provision of goods or services to persons in their private capacity. Common examples of goods are expensive watches, jewellery and art. Kinds of services that are offered include maintenance to private homes, travel and 'client entertainment';
- Corruption can also take on the form of making items available, for example the use of a holiday apartment or a car;
- Payments for the use of 'intermediaries' to obtain contracts;
- Corruption increasingly occurs in the form of promises of future payments. These deferred payments fit the pattern of 'quid pro quo' and 'scratch my back now and I'll scratch yours later'.

Corruption-related risks can arise through choices that management makes in relation to business activities, like choosing to do business in countries that are generally perceived to have higher risks of corruption. The responsibility to comply with legislation lies primarily with the client's management and those charged with governance. This also includes complying with legislation that combats corruption. In a situation where the client faces significant corruption-related risks, management can issue guidelines (for example codes of conduct, contractual conditions for agents) in order to prevent corruption and any prosecutions and reputation damage that could result from it.

As a result of EU Directive 2014/95/EU<sup>2</sup>, public-interest entities ('PIEs') with more than 500 employees must include non-financial information in their management reports, including a statement on combating corruption and bribery. A description must also be given of the policy applied by the entity concerned, the results of this policy, the risks attached to these topics, and the manner in which they are handled. If there is no policy relating to one or more of these topics, the non-financial information in the management report must include a clear and motivated explanation for this.

The Senate and House of Representatives of the Dutch Parliament have meanwhile adopted the legislative bill for amending Book 2 of the Dutch Civil Code in order to implement this directive. It will apply to management reports for periods that commence on or after 1 January 2017. This means that PIEs must report on this non-financial information for the first time in 2018.<sup>3</sup>

With regard to the client's responsibility related to the main risks and uncertainties of its entity (entities) on the basis of Article 391, Book 2 of the Dutch Civil Code, in connection with corruption, where relevant, in accordance with Richtlijn 400, paragraphs 109-110c of the Raad voor de Jaarverslaggeving (RJ, Guideline 400 of the Dutch Accounting Standards Board) the client is expected in its management report:

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<sup>1</sup> The preamble to this Convention specifically finds that bribery is a worldwide phenomenon which undermines good governance and economic development and is disastrous for international competition.

<sup>2</sup> See: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0095&from=EN>.

<sup>3</sup> See: <https://zoek.officielebekendmakingen.nl/stb-2016-352.html>. NBA is still consulting on the role and responsibility of auditors in relation to such non-financial information. Further information is expected during the course of 2017.

- to outline whether or not it is prepared to cover the risks and uncertainties, in this case related to corruption;
- to describe the internal controls that have been implemented;
- to set out the expected consequences of any risks and uncertainties;
- to state the risks and uncertainties that have been found to have significant consequences for the client; and
- to describe any improvements in internal control.

It is the auditor's responsibility to evaluate corruption-related risks during the risk analysis and, where necessary, to organise his audit procedures accordingly. As a rule, the auditor will not readily encounter straightforward recording of the above forms of corruption during an audit of financial statements. However, indications of corruption do occur in the accounting records. These indications of corruption are often revealed in transactions that the auditor may come across in his audit procedures.

These indications include:

- Excessive hospitality and entertainment;
- Expenses relating to lobby activities and sponsoring that are not adequately substantiated;
- Payments for the use of 'intermediaries', including agents whose commission is disproportionate to the agreed work;
- A long-term business relationship with an individual (foreign) official;
- Cash payments that are not adequately documented;
- Consultancy fees that are not adequately substantiated;
- Keeping an 'illicit fund'.

An attitude of professional scepticism may be expected from an auditor to risks and indications of corruption: the legal framework in a corruption issue (or indications of corruption) can be complicated and there is a risk that the auditor himself can become involved in that corruption (or the indications of it).<sup>4</sup>

## 1.2 Broader framework for the auditor in relation to corruption

The topic of corruption affects many aspects of how both the individual auditor and the audit firm functions. As a result of this, there is relevant legislation that audit firms and auditors must bear in mind when dealing with corruption issues. This legislation includes:

- Wet toezicht accountantsorganisaties (Wta)<sup>5</sup> in conjunction with the Besluit toezicht accountantsorganisaties (Bta);<sup>6</sup>
- Wet ter voorkoming van witwassen en financieren van terrorisme WWFT;<sup>7</sup>
- AFM-regeling incidentenmelding;<sup>8</sup>
- Verordening gedrags- en beroepsregels accountants;<sup>9</sup>
- Nadere voorschriften controle- en overige standaarden (NV COS)<sup>10</sup>, including the Dutch Standard 250 and the Dutch Standard 240.

### *Wta and Bta*

Under the [Wta](#),<sup>11</sup> the audit firm is obliged to provide a framework for controlled and ethical business operations. If there is possible corruption at a client, there is a risk that the audit firm could become involved in a negative sense. It is up to the audit firm itself to decide how to manage this risk and this depends on the nature and size of the audit firm, its clients and engagement portfolio. Examples of measures that could form part of the mix of measures at engagement and/or firm level<sup>12</sup> include:

- (measures that promote) an open and ethical culture;

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<sup>4</sup> Regulations on audits and reviews of financial statements and other assurance and related services engagements.

<sup>5</sup> Audit firms supervision act.

<sup>6</sup> Audit firms supervision decree.

<sup>7</sup> Money laundering and terrorist financing prevention act.

<sup>8</sup> Incident Reporting Regulation of the Netherlands Authority for the Financial Markets (AFM).

<sup>9</sup> Code of ethics for professional accountants, regulation with respect to professional conduct.

<sup>10</sup> Regulations on audits and reviews of financial statements and other assurance and related services engagements.

<sup>11</sup> [Article 21 of the Wta](#).

<sup>12</sup> See further the AFM publications of [December 2015](#) and [March 2016](#) for examples.

- easily accessible technical consultations;
- procedures for accepting and continuing client relationships that also focus on the risk of corruption.

Under [Article 26 Wta](#) in conjunction with Articles 36-38 Bta, an obligation to report exists if the auditor concludes there are reasonable grounds to suspect material fraud in case of a statutory audit engagement.

Material fraud is defined under [Article 36 Bta](#) as follows:

'an intentional act or omission by which deception is used to achieve an illegal advantage and where the nature or extent is such that decisions taken in social and economic life that are based on the audit client's annual report could be influenced by that deception.'

If the client refuses to adequately redress the fraud, the auditor will be obliged to report it under [Article 26 Wta](#).

#### *WWFT*

Under the [WWFT](#), the auditor reports unusual transactions.<sup>13</sup> In this way, the auditor provides a framework for controlled and ethical business operations. Based on the [WWFT](#), the auditor has an obligation to report unusual transactions: 'Transactions where the party that is obliged to report has reason to assume that these transactions could relate to money laundering or the financing of terrorism'. Whether a transaction is unusual in nature depends on the facts and circumstances. Where corruption exists, there is generally also an unusual transaction: often a benefit arising from a crime. Facilitating payments must also be evaluated in the context of the [WWFT](#). Unusual transactions must be reported to the Financial Intelligence Unit - Netherland (FIU-Netherland). The fact that facilitating payments which comply with the factors as described under the current prosecution policy of the Public Prosecution Service are not being prosecuted, does not affect the fact that these facilitating payments should possibly be regarded as unusual transactions.

In order to avoid duplication, reference is made to NBA Practice Note 1124 for more information on the [WWFT](#).

#### *AFM-regeling incidentenmelding*

Besides the above statutory obligations to report, there is also a possible obligation to report under the AFM-regeling incidentenmelding.<sup>14</sup>

#### *VGBA*

Under the fundamental principles of the VGBA, including the fundamental principle of integrity<sup>15</sup>, the auditor is also obliged to mitigate the risk of becoming involved in corruption himself. Where relevant, he takes into account information which he has become aware of, including via the process of accepting and continuing the engagement or client relationship and the performance of other engagements.<sup>16</sup>

#### *The Dutch Standards 250 and 240 viewed together*

Dutch Standards 250 and 240 are particularly relevant in relation to corruption.

#### *The Dutch Standard 250*

As part of his procedures, the auditor must be alert to risks that relate to compliance with laws and regulations, including regulations in the area of corruption and fraud.

The Dutch Standard 250 contains requirements that are aimed at assisting the auditor to identify material misstatements in the financial statements as a result of non-compliance with laws and regulations. The auditor is required to maintain an attitude of professional scepticism regarding non-

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<sup>13</sup> Besides the obligation for WWFT institutions to report unusual transactions, the WWFT also includes the obligation to perform customer due diligence, which can help the auditor to obtain an understanding of the client and its environment.

<sup>14</sup> <https://www.afm.nl/nl-nl/professionals/onderwerpen/interpretaties-incidentmeldingen>, regulation of the Dutch financial markets authority.

<sup>15</sup> Chapter 2.3, including Articles 7 and 9. The link in the main text provides a reference to the comprehensive literature that the NBA has published in this regard.

<sup>16</sup> See, for example, Standards 210 and 240, paragraph 23 in conjunction with A22.

compliance with legislation. This applies all the more to risks of corruption and fraud.

Identifying non-compliance with legislation can affect other aspects of the audit, for example, the auditor's reconsideration of the integrity of management or employees.

If the client fails to comply with laws and regulations, for example by cooperating in corruption, this may result in a material misstatement in the financial statements. As this can lead to penalties and compensation claims in case of corruption, provision must be made, or adequate disclosures must be included, in due time in the financial statements.<sup>17</sup>

#### *The Dutch Standard 240*

In the NV COS, fraud is defined as an intentional act by one or more persons from the group of management, those charged with governance, personnel or third parties, by which deception is used to obtain an illegal or unjust advantage. See Standard 240, paragraph 11(a). Fraud therefore involves three characteristics:

- intent;
- deception;
- illegal advantage.

In case of corruption, these fraud characteristics will nearly always play a role. It is difficult to envisage corruption without the two fraud characteristics of intent and illegal advantage: the illegal advantage is the purpose of the corruption act and that act happens intentionally. There will nearly always also be deception (of the intended preferential treatment): by the party that pays bribes, the recipient, or by both.

Contrary to the prejudice to the client in 'ordinary' fraud, there is a risk in case of corruption that individual employees at various (management) levels use the short-term financial 'advantage' for the client to justify corruption.<sup>18</sup> Because of this 'advantage', people may be more receptive than in case of 'ordinary' fraud to consorting with corruption and finding it 'acceptable'. It should be clear that this is no justification for corruption.

In view of the nature of the corruption risk, the auditor will treat this risk in the same way as a fraud risk for the purpose of his risk analysis. If the auditor has identified the risk of a material misstatement as a result of corruption, it follows that the auditor will regard this risk as significant (under Standard 240 the risk of a material misstatement due to fraud is also regarded as a significant risk).<sup>19</sup>

If there are indications of corruption, as in the case of an indication of fraud, the auditor will perform additional procedures to determine the nature and extent of possible violations.

This Practice Note aims to set out the topic of corruption on the basis of the Dutch Standard 250 and the Dutch Standard 240. The basic premise is that by complying with these Standards, among others, the auditor is complying with the above regulation.

### **1.3 Aim and scope**

This Practice Note provides the auditor with reference points to identify corruption risks in his risk analysis for the audit of the financial statements and, consequently, to implement further audit procedures that are deemed necessary.

This Practice Note also contains reference points for any indications of corruption and for the additional procedures that are then necessary to determine the nature and extent of the possible corruption.

The starting point for this Practice Note is what the auditor should do at an audit client regarding the risk analysis on the basis of the requirements in the Dutch standards on auditing.

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<sup>17</sup> Since January 2015, [Article 23\(7\) of the Dutch Criminal Code](#) has applied with a maximum penalty of 10% of the turnover from the previous financial year.

<sup>18</sup> Rationalisation as one of the three elements of the fraud triangle, along with pressure and opportunity.

<sup>19</sup> The Dutch Standard 240, paragraph 27.

*Application to engagements other than the audit of financial statements*

This Practice Note has been written primarily for auditors (auditors in public practice, internal auditors and public-sector auditors) who perform audit engagements on financial statements. This Practice Note also provides auditors with background information that can be useful in their provision of other services. This background information is mainly described in [Chapter 3](#) of this Practice Note. In order to prevent any misunderstandings: the [WWFT](#) applies to the professional activities of accountants for third parties.

#### **1.4 Overview**

[Chapter 2](#) of this Practice Note is a summary of the relevant law and regulation, including an international context. This Practice Note also explains the difference between bribery-related payments and facilitating payments. [Chapter 3](#) describes alertness to corruption risks relating to specific countries, activities and transactions. Corruption risks and the audit of financial statements are discussed in [Chapter 4](#). The procedures that must be performed if there is an indication of corruption, based on Standards 240 and 250, are set out in [Chapter 5](#). Lastly, [Chapter 6](#) describes communication with those charged with governance regarding findings of corruption or risks of corruption.

In order to assist the reader, a table containing the relevant laws and regulations for each chapter, focusing on corruption among other subjects, follows below.

Chapter	Subject	Law and regulation
<a href="#">1.1</a>	Rationale	Anti-Bribery Convention (OECD), Article 391, Book 2 of the Dutch Civil Code, <a href="#">Dutch Act of 28 September 2016, amending Book 2 of the Dutch Civil Code in order to implement Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups (OJEU 2014, L 330)</a> (only for PIEs with more than 500 employees), DASB Guideline 400, paragraphs 109-110c
<a href="#">1.2</a>	Laws and regulations framework	<a href="#">Wta</a> in conjunction with Articles 36-38 Bta, <a href="#">WWFT</a> , AFM-regeling incidentenmelding, VGBA, NV COS, including the Dutch Standards 250, 240 and 210
<a href="#">2.1.1</a>	Definition of corruption	Dutch Criminal Code on bribery
<a href="#">2.2.2</a>	Definition of facilitating payments	Anti-Bribery Convention (OECD), Dutch Criminal Code, Dutch Public Prosecution Service prosecution policy
<a href="#">2.2</a>	Explanation of the scope of the US FCPA	<a href="#">US Foreign Corrupt Practices Act</a>
<a href="#">2.3</a>	Explanation of the scope of the UK Bribery Act	<a href="#">UK Bribery Act</a>
<a href="#">4</a>	Corruption risks and audit of financial statements	The Dutch Standards 240, 250, 315, 320, 330 and 580
<a href="#">5</a>	Procedures where there is an indication of corruption	The Dutch Standards 240, 250 and 260
<a href="#">6</a>	Communication	The Dutch Standards 240, 250, 260, 265, 700-720

References to specific provisions of laws and regulations are not included in this table because of the large number involved.

## 2 Laws and regulation framework

Chapter [2.1](#) explains the Dutch law and regulation and Chapters [2.2](#) and [2.3](#) explain the laws and regulations on corruption in the United States and the United Kingdom. The short discussion of this international legislation is intended to emphasize the importance of this Practice Note. It is not intended to be a thesis on comparative international law. Chapter [2.4](#) discusses the importance of any internal corporate code of conduct of the client.

### 2.1 Dutch law and regulation

#### 2.1.1 What is meant by corruption?

Corruption is not only relevant in the relationship between the client and public officials (known as 'official corruption'), but also in the private sector. Reference to 'corruption' in this Practice Note relates to issues in the area of bribery and conflicts of interest.

Corruption can be both active and passive: bribing employees of a third party that supplies products or performs services for the entity (active) or employees that are bribed by third parties (passive).

Articles [177](#) and [178](#) of the Dutch Criminal Code make the bribery of officials and judges a punishable offence in the Netherlands: *giving a gift, making a promise, or providing or offering a service with the aim of inducing the other party to do, or refrain from doing, something in connection with their duties*. Anyone from abroad who bribes a Dutch official, or any Dutch person who bribes a foreign official in the Netherlands, can also be prosecuted. More generally, if there is a clear relationship with the Netherlands, the Dutch Public Prosecution Service has jurisdiction (extraterritorial reach), for example, when Dutch legal subjects are represented on the board of a foreign subsidiary or when a foreign subsidiary holds a bank account at a Dutch bank.

The active or passive bribery of persons working in the private sector is a punishable offence under Article [328ter](#) of the Dutch Criminal Code. These criminal provisions cover any form of non-official corruption. A distinctive feature of Article [328ter](#) is that criminal liability for bribery (or being bribed) depends on whether the perpetrator or recipient acted contrary to their obligation towards their employer or principal. This occurs in any case if the perpetrator or recipient fail to disclose the corruption to their employer or principal. If openness is exercised with these parties, there is no criminal act under Article [328ter](#). However, criminal liability arises if there is an act contrary to this openness, or if the person offering the money is expected not to pursue this openness. This differs from the criminal provision in case of official corruption.

[Articles 363](#) and [364](#) punish officials and judges who allow themselves to be bribed: *accepting a gift, promise or service, knowing or reasonably suspecting that the person giving, making or offering it is doing to induce him to do, or refrain from doing, something in connection with his duties*.

#### 2.1.2 What is meant by facilitating payments?

A distinction is often made internationally between corruption payments and facilitating payments. Under the OECD Convention, facilitating payments are not subject to the obligation to punish the corruption of foreign officials. Corruption involves payments or gifts that induce someone to perform an act. Facilitating payments are smaller amounts that induce someone to perform an act quickly. Dutch criminal law does not make this distinction. In the Netherlands, facilitating payments are also subject to the definition of official corruption in criminal law and are punishable.

The auditor's role is to examine whether there have been any facilitating payments. Chapter [4.4.3](#) discusses the auditor's substantive procedures in relation to the Public Prosecution Service's [prosecution policy](#) in this regard:

- It relates to acts or omissions where the *foreign official* concerned already has an obligation<sup>20</sup>. The payment may not distort competition in any way;
- It involves absolute or relatively small amounts;
- It relates to payments to lower-ranking *foreign officials*;

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<sup>20</sup> Other facilitating payments, such as to Dutch officials, may be subject to prosecution.

- The gift must be included transparently in the entity's accounting records<sup>21</sup>, and may not be concealed; and
- The initiative for the gift must be taken by the *foreign official*.

The auditor also evaluates facilitating payments in the context of the WWFT.

It is up to the Public Prosecution Service to decide based on opportunity-related considerations whether or not to prosecute in case of facilitating payments. For this reason, the auditor is not led by the [Public Prosecution Service's prosecution policy](#) in his role and procedures when evaluating facilitating payments.

Local laws and regulations determine whether facilitating payments are punishable in jurisdictions outside the Netherlands. With the exception of what follows in Chapters [2.2](#) and [2.3](#), this Practice Note accordingly does not contain an international comparison of facilitating payments in jurisdictions outside the Netherlands.

## 2.2 Foreign Corrupt Practices Act

In addition to the Dutch Criminal Code, entities may have to deal with the US [Foreign Corrupt Practices Act of 1977](#) (FCPA). The FCPA makes the bribery of foreign (non-US) officials a punishable offence. This Act also sets requirements for internal control and the transparent accounting of transactions. Facilitating payments are not punishable, provided that they comply with stringent FCPA conditions.

The provisions of the FCPA apply to both US nationals and businesses that operate worldwide and to non-US nationals and businesses with listed securities in the United States. The provisions may also apply to acts that take place in or via US banking or communication facilities, including e-mail, for example when two non-US businesses perform a transaction via a US bank. This is what is known as extraterritorial reach.

The US Department of Justice (DoJ), among others, has published [guidance](#) against corruption.

## 2.3 UK Bribery Act 2010

Like the FCPA, the UK [Bribery Act 2010](#) also has extraterritorial reach. The provisions of the UK Bribery Act do not apply only to British residents, but also to foreign nationals and entities that have business or other activities in the United Kingdom. In contrast to the FCPA, the UK Bribery Act covers both official and non-official corruption. As in the Netherlands, both active and passive corruption are punishable. Again in contrast to the FCPA, facilitating payments are not permitted under the UK Bribery Act.<sup>22</sup> This Act also contains provisions on internal control for the prevention of corruption.<sup>23</sup>

## 2.4 Internal corporate codes of conduct

Besides the laws and regulations that apply to them, clients often have their own internal corporate codes of conduct regarding anti-corruption. Such a corporate code of conduct, including how the client implements it, evaluates its operating effectiveness and adjusts it, forms an important framework for the auditor during the audit of the financial statements.

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<sup>21</sup> It is not necessary for the gift to be shown transparently in the financial statements.

<sup>22</sup> This can be in conflict with Dutch prosecution policy: facilitating payments in a subsidiary in the Netherlands also affect the British parent company that processes the related information in the consolidated financial statements.

<sup>23</sup> Section 7 of the UK Bribery Act contains provisions that allow the client's management to rely on adequate anti-corruption procedures that it has implemented if a person associated with the client commits corruption. Section 9 contains provisions that the British government have commissioned to provide [guidance](#) that can support businesses in combating corruption via their internal control.

### 3 Alertness of corruption risks

As part of his risk analysis, the auditor will identify risks of material misstatement due to corruption. The extent to which these inherent risks (known as factors) of material misstatement due to corruption occur depends, among other things, on the country in which activities are performed and/or the sector in which the client operates.

The auditor can include the following client-specific circumstances in his risk analysis:

- 1 The geographical place where the activities are performed. The chance of corruption relating to activities in a certain region or continent differs from the same activities in another region or continent.
- 2 The culture of the sector/client. How is business conducted within the sector or by the client? What is the prevailing 'tone at the top' among the main market players? And has the sector attracted negative news headlines lately?;
- 3 The transparency of how business is conducted (for example, the extent to which tender processes are public and verifiable); and
- 4 The ability to follow the flow of cash from the source to the final beneficiary.

The first two points are detailed in Chapters [3.1](#) and [3.2](#) of this Practice Note. The third and fourth points can also form part of the examples of alertness to (increased) risks of corruption in Chapter [3.3](#).

#### 3.1 Activities in countries with a higher risk of corruption

Corruption is more common in some countries than others. The extent to which corruption occurs is firstly culture-specific and secondly depends on the extent to which relevant anti-corruption legislation exists and is enforced. Increased political instability also causes more corruption.

Economies of certain countries in Africa, Asia, Latin America and the Middle East are characterised by fast development. Quick economic growth can be accompanied by an increasing risk of corruption. Corruption can arise, for example, in contacts with local officials when obtaining the necessary permits or licences to start activities, with customs officials when importing goods, and with officials involved in monetary supervision when transferring money out of the country. Officials often earn less than private-sector employees and may be more inclined to accept bribes in order to increase their income.

Dutch companies (whether or not via foreign parent or group companies) may have to deal with risks of corruption through business dealings in continents or countries that are more vulnerable to corruption. Corruption risks that occur in a foreign group company, for example, also affect the Dutch parent company that processes the group company's accounting records in the consolidated financial statements.

There are several sources of information about the extent to which corruption is observed and/or can occur in certain countries. These sources also provide recommendations and instruments for preventing corruption:

- 1 Transparency International publishes the '[Corruption Perception Index](#)' each year.<sup>24</sup> This index provides the relative ratio among countries of the extent to which public-sector corruption is observed by business people and country experts. The higher a country appears in the index, the less corruption that is observed in comparison to other countries.
- 2 Another index of Transparency International is the '[Global Corruption Barometer](#)'. This index is based on a survey conducted among 114,000 people worldwide into their observations of corruption. The outcome of the survey can be viewed separately for each of 107 countries. According to the '[Global Corruption Barometer 2013](#)'<sup>25</sup> report, one out of every four respondents, on average, has paid a bribe to government bodies, with the police, justice and registries such as the land register (or similar institutions) being the most commonly mentioned.
- 3 Country corruption profiles can also be found at [www.business-anti-corruption.com](http://www.business-anti-corruption.com). This website also provides various tools for the prevention of corruption, such as anti-corruption compliance systems, due diligence instruments and e-learning.
- 4 The Organisation for Economic Co-operation and Development (OECD) has drawn up [guidelines](#)

<sup>24</sup> <http://www.transparency.org/research/cpi/>.

<sup>25</sup> <http://www.transparency.org/gcb2013>.

with recommendations for entities to prevent and combat corruption. The auditor can use these recommendations as a starting point for discussing this topic with his clients.

- 5 The Financial Action Task Force (FATF) has published a [document](#) entitled 'Specific risk factors in laundering the proceeds of corruption' on this topic.<sup>26</sup>
- 6 In conjunction with VNO-NCW<sup>27</sup>, MKB Nederland<sup>28</sup> and the International Chamber of Commerce for the Netherlands, the Dutch government has created a [brochure](#) about honest and corruption-free business dealings (abroad).<sup>29</sup> This brochure offers various practical tips for entrepreneurs abroad to prevent corruption.
- 7 De Nederlandsche Bank<sup>30</sup> has published the [brochure 'Good practices bestrijden corruptie'](#) (Good practices combat corruption).

### 3.2 Activities in sectors with a higher risk of corruption

Sectors in which corruption (whether or not combined with tendering) occurs more frequently include property, construction/infrastructure, government/semi-government, the pharmaceutical sector, defence, shipping, commodities mining and trade, sports, the telecommunications sector, development aid services and the energy sector.

These sectors are characterised by relative large transactions that are often concluded through third parties. The complexity of the product or process connected to the above sectors can also lead to the lack of a transparent market price, as a result of which the possibilities for paying bribes increase.

Clients who operate in these sectors often deal with officials. The client's interests may be significant, for example acquiring government contracts, working with local authorities or obtaining permits or licences. This can increase the risk of non-compliance to corruption-related laws and regulations. Corruption risks can also occur outside the public and semi-public sectors. Corruption risks can also exist between private parties, for example in a client's purchase process, in which a buyer agrees higher prices with the supplier and then benefits from a personal kickback.

Each sector has its own characteristics, which can give rise to sector-specific forms of corruption. Bribes are used in relation to commodities mining and trade, for example, in order to obtain illegal licences for concessions. And corruption in development aid services can mean that donations are not spent on those in need.

Local companies that are involved in commodities mining and trade and the energy sector are state-owned in many countries. Employees of these companies are seen in many jurisdictions as officials. Other sectors, including construction, infrastructure and shipping, deal equally with officials because they need permits or licences for their activities and the government is one of their main customers.

### 3.3 Examples of alertness to (increased) risks of corruption

#### 3.3.1 *Relatively large transactions*

The interests at stake when entering into large transactions generally differ from those in smaller transactions: in large transactions, the risk of corruption is estimated to be higher because the interests at stake are more significant.

Relatively large transactions make it easier to pay bribes. As the ratio between the size of bribes and the size of the underlying transactions increases, this offers more opportunities to conceal the payment of bribes. It is also pointed out, albeit superfluously, that corruption risks can exist in both the purchase and sales process.

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<sup>26</sup> More information in connection with corruption can also be found on the website <http://www.fatf-gafi.org/publications/corruption/documents/bpp-fatfrecs-corruption.html> and elsewhere.

<sup>27</sup> Confederation of Netherlands' industry and employers.

<sup>28</sup> Association of small and medium sized entrepreneurs in the Netherlands.

<sup>29</sup> <http://www.rijksoverheid.nl/onderwerpen/maatschappelijk-verantwoord-ondernemen/documenten-en-publicaties/brochures/2012/10/02/eerlijk-zakendoen-zonder-corruptie.html>.

<sup>30</sup> The Dutch central bank.

### 3.3.2 *Transactions through third parties*

Third parties can be hired to help secure new contracts, organise necessary permits or licences, or for the performance of operational activities. Third parties, such as agents or intermediaries, are often hired for potential transactions abroad in order to be able to do business at the right level. They have a network to be able to contact 'the right people' or can create the necessary preconditions (such as permits or licences) to be able to do business in the country concerned.<sup>31</sup> The use of local third parties may also be compulsory under local regulations.

The use of third parties (agents/intermediaries) can result in increased corruption-related risks for the client: the activities of an agent, for example, are not subject to the client's direct internal control environment. Controlling a third party's consultancy services can be more difficult in certain cases ('measuring the performance'). Agents are sometimes involved in well-known corruption cases.

It is clear from the 'instructions for investigating and prosecuting foreign corruption' that Dutch institutions are expected to have a critical attitude towards the nature and extent of an agent's or intermediary's activities. For example, the advice of a person or institution may be followed only if such authority can be attached to their advice that the soundness of it can reasonably be trusted.<sup>32</sup>

### 3.3.3 *Transactions that are concluded on the basis of a success fee*

The existence of a success fee may be the decisive reason why a transaction is concluded. The size of the success fee does not have to relate to the scope of the work performed to bring about the transaction. The financial incentive can be a reason for the party receiving the fee to secure a transaction through improper means, such as by paying bribes. A success fee is normally paid to an agent or intermediary.

### 3.3.4 *Transactions where the performance (goods or services) is difficult to value*

Goods or services that are difficult to value, such as real estate, works of art, project development, software, consultancy services, etc., usually offer a larger opportunity to factor bribes into the price than goods or services with a fixed or market price. If the description of the invoice does not correspond to the actual goods or services supplied, this could also amount to forgery of documents. Transparency about pricing, any cost calculation models and possible price references can limit this risk.

### 3.3.5 *Transactions that make use of personal networks*

As soon as the interests of employees conflict with those of the entity, there is an increased risk of corruption. The chance of a conflict of interests increases as soon as products or services are purchased from entities or sold to entities that are linked to employees or their personal relationships.

Employees may occupy certain ancillary positions that bring them into conflicting situations with their current position. A conflict of interests, or the appearance of a conflict of interests, arises if the ancillary position could relate to or be an extension of the activities of the employee's employer. An example would be an employee who is also a municipal councillor or active member of an important local political party in a municipality with which the employer has a business relationship. The approval and registration of ancillary positions and activities helps to identify risks relating to conflicts of interest in due time.

### 3.3.6 *Transactions where decision-making is in the hands of a limited number of people*

The aim of corruption is to improperly influence decision-making in relation to transactions. Corruption in the form of bribes is easier to organise if fewer people are involved in the corrupt acts. In other words, the fewer people who are involved in the decision-making, the fewer people who need to be bribed.

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<sup>31</sup> WWFT client screening can reveal a relationship between an ultimate beneficial owner (UBO) and a politically exposed person (PEP). This can affect how the auditor monitors the business relationship with such a client and the decision whether or not to continue the business relationship.

<sup>32</sup> See '[Aanwijzing opsporing en vervolging buitenlandse corruptie, Facilitation payments](#)' (Instructions for investigating and prosecuting foreign corruption, Facilitating payments).

### 3.3.7 *Transactions that make use of cash*

Corruption may involve cash payments. The advantage for the recipient is that the flow of cash leaves no paper trail in their own accounts. Transactions that are settled in cash may involve some corruption. During business trips, for example, cash payments for 'travel and accommodation expenses' may be used to influence officials or employees of business clients. Indications of possible corruption using cash are visible in transactions that are normally settled via bank transactions (for example transport costs or the purchase of production resources) and thus deviate from the normal payment process.

### 3.3.8 *Transactions whose settlement occurs in an unusual or inexplicable way*

Transactions where payments are made into bank accounts in countries other than the country in which the supplier and customer are registered (e.g. tax havens) may be indicative of corruption. Reference can also be made in this regard to payments into bank accounts that do not correspond to the contract, or over-invoicing without adequate substantiation.

### 3.3.9 *Transactions without any (visible) reciprocation*

Sponsoring is a type of transaction where the costs of the visible reciprocation (e.g. attribution) are disproportionate to the sponsored amount. In such transactions, the question that arises is what interest the client, or its employee, has in the sponsoring and/or whether that interest compensates for the costs. If a convincing answer to this question is lacking and/or officials, customers or suppliers are involved in the sponsored organisation, this can indicate a risk of corruption.

Corruption can occur in many ways and it is not possible to cover all indicative risks in this NBA Practice Note. Nonetheless, it is important that the auditor is alert during his risk analysis to the above client-specific circumstances, to the client's internal control relating to these circumstances and that he performs extra audit procedures, where necessary. If various client-specific circumstances exist that possibly point to an increased risk of corruption, it is recommended to involve forensic experts in the risk analysis.

## 4 Corruption risks and the audit of financial statements

### 4.1 Introduction

Depending on the client-specific circumstances (see [Chapter 3](#)) which the auditor has identified, he will assess, based on Standards 315, 240 and 250, whether those circumstances lead to risks of material misstatement due to corruption in the financial statements and assertions.

The term materiality is used in Standard 320. Materiality (in both a quantitative and qualitative sense) usually involves the following:

Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements<sup>33</sup>; misstatements can also relate to ~~notes~~ disclosures.<sup>34</sup>

In order to evaluate whether a matter is material, including in a qualitative sense, with the focus on corruption, the following are taken into account:

- Classes of transactions in which possible corruption risks can arise, like payments to agents/intermediaries or classes of transactions that relate to entertainment/sponsoring;
- The involvement of management in classes of transactions in which the risk of corruption can arise;
- Any past corruption-related incidents;
- Tone at the top, the corporate culture, the degree of involvement of internal supervisory bodies (supervisory board members, supervisory board, audit committee);
- Policies and procedures, risk appetite of management;
- Existence of an internal audit department;
- Remuneration and bonus structures;
- Relevant legislation in the area of corruption.

Among others, Standard 240 contains references to document requirements (in other standards), including an understanding of the client and its environment, the assessment of risks of a material misstatement, how to respond to the assessed risks, and substantiation for the conclusions drawn in respect of these risks.

If the auditor, based on his professional judgement, has identified the risk of a material misstatement because of corruption, including on the basis of qualitative aspects, he will also regard that risk as a significant risk for the purpose of the audit.<sup>35</sup>

This chapter describes how the auditor can respond to this during the audit of the financial statements.

The following topics are discussed in sequence:

- Obtaining an understanding of the design and implementation of the client's internal control with regard to corruption risks;
- Obtaining an understanding of the operating effectiveness of the client's internal control on corruption risks;
- Obtaining audit evidence based on substantive audit procedures;
- Requesting to provide written representations.

### 4.2 Obtaining an understanding of the design and implementation of the client's internal control with regard to corruption risks

If the auditor has considered that corruption risks potentially exist and could be regarded as a risk of material misstatement due to corruption, he will treat these risks as significant<sup>36</sup>. He shall exclude the client's internal control for the purpose of his risk assessment<sup>37</sup>. In order to give direction to the audit, the auditor will obtain an understanding into the internal control that is relevant for mitigating these

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<sup>33</sup> Standard 320, paragraph 2.

<sup>34</sup> Standard 320, paragraph 9.

<sup>35</sup> Standard 240, paragraph 27.

<sup>36</sup> The Dutch Standard 240, paragraph 27.

<sup>37</sup> The Dutch Standard 315, paragraph 27.

corruption risks.

In general, clients that are assessed as having a higher corruption risk, for example those which operate internationally, also often have implemented specific measures to mitigate those risks.<sup>38</sup> The client's anti-corruption program further depends on the law and regulation on corruption relevant to the client.<sup>39</sup>

In accordance with Dutch Standards 315, 240 and 250, among others, the auditor shall obtain an understanding into the risks of a material misstatement.<sup>40</sup> The following with focus on corruption are to be included :

- Using his knowledge of the sector and the client;
- Using corruption-related knowledge that exists within his own office or reading publications on corruption (also see [Chapter 3](#));
- Obtaining an understanding of the client's business principles and internal corporate code of conduct, see [Chapter 2.4](#);
- Inquiry of management and, if these positions exist, from employees including the head of internal auditing, the compliance officer, the head of legal affairs and/or others, regarding laws and regulations on corruption that apply to the client, in addition to Dutch regulations;
- Inquiry of management and, if these positions exist, from employees include the head of internal auditing, the compliance officer, the head of legal affairs and/or others, regarding the client's internal control activities to comply with laws and regulations on corruption. Examples in this regard include:
  - procedures relating to compliance with the client's internal corporate code of conduct;
  - procedures relating to the use of agents/intermediaries;
  - procedures relating to accepting or giving business gifts;
  - procedures relating to ancillary activities;
  - procedures relating to entertainment and sponsoring.

#### *Clients that are susceptible to the risk of material misstatement due to corruption*

In case of clients that are susceptible to the risk of a material misstatement as a result of corruption (see [Chapter 3](#) for examples), the auditor expects an internal control system in place that suffices to mitigate this risk, for example an anti-corruption programme. This is because of the client's responsibility for (the internal control as it determines necessary for) financial statements that comply with the applicable financial reporting framework. Such a programme can consist of the following elements (among others):

#### 1 Risk analysis

By being able to effectively and efficiently adopt measures against corruption, the client can identify where it is vulnerable to corruption. Examples include business activities that by their nature are more vulnerable to corruption, such as purchase and sales, business dealings with officials in countries with a higher risk of corruption, using agents, etc. Reference is made to [Chapter 3](#) of this Practice Note for further details.

#### 2 Anti-corruption policy

If applicable, the client is obliged to have an anti-corruption policy on the basis of local laws and regulations, the FCPA<sup>41</sup>, and the UK Bribery Act<sup>42</sup>. In this way, the client makes it clear to employees and third parties that corruption will not be tolerated. The anti-corruption policy gives employees information on risk areas and how employees are expected to act. It also encourages employees to report violations of the anti-corruption policy.

#### 3 Procedures relating to the use of third parties

The use of third parties, including agents and consultants, may involve corruption risks. It is up to the client to adopt measures in order to mitigate such corruption risks. Such restrictive measures include:

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<sup>38</sup> See Chapter 1.1, paragraph 5.

<sup>39</sup> See Chapters 2.2 and 2.3.

<sup>40</sup> The Dutch Standard 315, paragraph 11; The Dutch Standard 240, paragraphs 16-24 and A16; The Dutch Standard 250, paragraph 12.

<sup>41</sup> For guidance, see: <http://www.justice.gov/criminal/fraud/fcpa/guidance/>.

<sup>42</sup> For guidance, see: <http://www.justice.gov.uk/downloads/legislation/bribery-act-2010-guidance.pdf>.

- the client runs background checks on these parties;
- the client imposes its own anti-corruption policy on these third parties;
- the client has legal checks performed on contracts; and, where possible,
- the client has an audit conducted at the agent.

#### 4 Implementing internal control activities

Adequate internal control is important in order to identify corruption in due time. This relates, for example, to introducing strict rules for travel and expense allowances, and verifying compliance with these rules. Another example is checking transactions for specific characteristics (e.g. transactions in certain countries, cash payments), the introduction of authorisation and reporting procedures, controls relating to cash and banking transactions, prior approval for entering into transactions with suppliers and payments, as well as increased attention to high-risk transactions.

An important aspect of internal control is to always have employees, particularly those who are vulnerable to corruption (e.g. buyers), work under the 'four-eyes' principle. The client implements procedures for this purpose aimed at employees maintaining joint contact with third parties (in frequently changing compositions).

#### 5 Anti-corruption training

Employees who occupy a position in which they can be exposed to corruption can be made more assertive to the risk of corruption by periodically attending anti-corruption training. Training can be conducted risk-based, for example vulnerable groups receive personal training and less vulnerable groups attend training via the Intranet.

#### 6 Monitoring of the anti-corruption programme

The client can periodically conduct compliance audits to monitor the compliance with the anti-corruption programme. Among other things, data analysis can be used to detect any irregularities (for example analysing payments to agents based on a list of accepted agents).

#### 7 Anti-corruption procedures in acquisitions and mergers

In acquisitions and mergers, there is a risk that business units in which there has previously been corruption will be integrated. For this reason, it is recommended that clients perform a comprehensive anti-corruption due diligence in case of an acquisition or a merger.

If an auditor determines that a significant risk of material misstatement (quantitative/qualitative) exists, he shall obtain an understanding of the client's internal control relating to that risk.<sup>43</sup> In case of a significant risk, the auditor shall perform substantive audit procedures (see [Chapter 4.4](#)) and can rely, where possible, on the operating effectiveness of the internal controls<sup>44</sup> (see [Chapter 4.3](#)) in order to obtain sufficient appropriate audit evidence. Where there are indications of corruption, the auditor considers holding technical consultations and/or involving specialists, such as forensic experts, in the audit, see [Chapter 5](#).

#### Examples of audit procedures for obtaining an understanding of the design and implementation of internal control by the client relating to laws and regulations on corruption :

- Interviews with management and, where appropriate, the head of internal audit, the compliance officer, the head of legal affairs and/or others regarding corruption risks, the design and implementation of the anti-corruption programme and other control measures adopted by the client;
- Obtaining an understanding of the procedures and measures included in the client's anti-corruption programme;
- Obtaining an understanding of the corruption risk analysis that the client has conducted itself;
- Obtaining an understanding of the training programmes;
- Obtaining an understanding of the reports on the outcomes of the compliance audits and/or the compliance due diligences;
- Obtaining an understanding of the client's periodic incident/exception reports.

<sup>43</sup> See the Dutch Standard 315, paragraph 29.

<sup>44</sup> For design and implementation in any case, see the Dutch Standard 330, paragraph 21.

**Examples of audit procedures for obtaining an understanding of the design and implementation of internal control by the client relating to laws and regulations on corruption :**

- After having obtained an understanding of the client's anti-corruption programme:
  - Determining the existence of procedures for screening agents/intermediaries;
  - Determining the implementation of procedures for business gifts or ancillary positions;
  - Determining whether the invoices of agents/intermediaries are authorised.

**4.3 Obtaining an understanding of the operating effectiveness of the client's internal control on corruption risks**

Where appropriate, in case of significant corruption risks and where it is appropriate to conduct tests of controls on the operating effectiveness of controls<sup>45</sup>, the auditor will test the client's internal control to determine the operating effectiveness of the internal control on corruption risks, for example by performing the following procedures:

- Inquiry of the relevant officers of the client (head of internal audit, compliance officer, head of legal affairs, employees in positions vulnerable to corruption, such as procurement, employees involved in due diligence, in anti-corruption training and the anti-corruption programme);
- Performing tests of controls, for example testing the operating effectiveness of internal control in the area of corruption, in relation to:
  - Updating the risk analysis in the area of corruption;
  - Selecting agents on the basis of internal due diligence processes;
  - Analysing and finalising incident reporting in the area of corruption, including the evaluation of external investigation reports;
  - Approving and paying invoices of agents/intermediaries;
  - Approving and paying invoices in connection with entertaining and/or sponsoring costs;
  - Approving major sales contracts, for example on the basis of a 'four-eyes principle';
  - Complying with procedures for reporting ancillary positions held by critical officials;
  - Complying with compulsory training in the area of anti-corruption;
  - Complying with procedures relating to business gifts (both given and received by the client).

Using such procedures, the auditor can evaluate the operating effectiveness of the internal control.<sup>46</sup> Based on this evaluation, the auditor can determine the scope of the substantive audit procedures.

If the operating effectiveness of the client's internal control regarding risks of material misstatement due to corruption (for example in the form of an anti-corruption programme), is not sufficient and relevant (in the opinion of the auditor), or the auditor decides not to rely on the internal control, the auditor shall obtain sufficient appropriate audit evidence exclusively via substantive procedures, including tests of details.<sup>47</sup> For examples, see [Chapter 4.4](#).

**4.4 Obtaining audit evidence based on substantive audit procedures**

**4.4.1 General**

If the operating effectiveness of the client's internal control regarding risks of material misstatement due to corruption is not sufficient and sufficiently relevant (in the opinion of the auditor), or the auditor decides not to rely on the internal control, the auditor will perform, as part of substantive procedures, analytical procedures and tests of details for those classes of transactions and account balances in the financial statements in respect of which significant corruption risks have been identified.

The substantive procedures to be performed depend on the client-specific circumstances. Examples of the substantive procedures for the following situations are set out below:

- payments to agents, including for acquiring contracts;
- facilitating payments;
- transactions with authorities;

<sup>45</sup> See the Dutch Standard 330, among others.

<sup>46</sup> Under the UK Bribery Act 2010, a lack of internal control qualifies as a separate punishable offence. A lack of internal control is furthermore already material from a qualitative perspective.

<sup>47</sup> See the Dutch Standard 330, paragraph 21.

- cash payments;
- travel and accommodation expenses;
- purchases, including tenders and the risk of kickbacks.

#### 4.4.2 *Payments to agents, including for acquiring contracts*

The client's use of third parties, including agents and consultants, may involve a corruption risk. It is important that the client has formulated a policy and adopted adequate internal controls to limit the risk of corruption by agents.

The amount to be paid in commission to the agent depends on the specific circumstances for which the agent is hired. The auditor may involve the following aspects in his evaluation of the use of agents and the commissions paid:

- the services for which the client hires the agent: for acquiring contracts, attending to local operational affairs, or both;
- the nature of the contracts for which the client hires the agent: expensive capital goods and/or other types of intensive projects or, for example, low-priced goods;
- the method and frequency of the agent's accountability and/or reporting;
- how the agent invoices and how the invoice must be paid;
- the country where the agent is located;
- the size of the region in which the agent represents the client's interests;
- the availability of agents in a specific region/sector;
- relevant local legislation that possibly makes it compulsory to use local agents, including possibilities for audits;
- whether the agent is a natural person or an entity;
- whether the audit client makes payments to bank accounts in countries with an increased risk of corruption, as described in [Chapter 3.1](#).

#### **Examples of possible audit procedures:**

- Performing analytical procedures on the commissions paid. The auditor analyses any commissions paid against the client's policy and, in the absence of such a policy, against the knowledge and experience of forensic experts on the customs and practices in the sector itself or other related sectors in the region (as recorded in the contract with the agent). An attitude of extra professional scepticism is expected in this regard;
- Based on a test, including in case of deviations from the analytical procedures, going through a number of agent contracts to examine the arrangements for the activities to be performed, reporting, remuneration and the right of audit. For this purpose, attention is paid to several aspects such as the formation of contracts, legal provisions relating to corruption that are included in contracts, and the due diligence performed by the client on the agent, including any audit at the agent;
- Matching the amounts charged on the basis of the contract/invoice with the actual services rendered by the agent (based on other underlying documentation, including correspondence with the agent). For this purpose, the auditor takes into account the possibility that the contracts and descriptions on the invoices do not correspond with the actual services rendered by the agent (so-called 'false' contracts and invoices);
- Based on a test, checking internal procedures for the actual payment of commissions on the basis of the contract, invoice, service rendered and banking documents;
- Independently investigating public sources to gather facts about an agent;
- Requesting the agent to provide written representations.

#### 4.4.3 *Facilitating payments*

Facilitating payments are punishable. Besides opportunity-related considerations, prosecution by the Dutch Public Prosecution Service depends on whether a facilitating payment complies with its prosecution policy in this regard. In order to determine whether a payment qualifies as a facilitating payment in accordance with the stringent conditions of the prosecution policy of the Dutch Prosecution Policy, as outlined in [Chapter 2.1.2](#), the auditor will assess the payment as follows:

**Examples of possible audit procedures:**

- Determine that small amounts are involved;
- Determine that acts or omissions where the foreign official concerned already has an obligation are involved;
- Determine that the payment does not distort competition in any way;
- Determine that payments to lower-ranking foreign officials are involved;
- Determine that the gift has been included transparently in the entity's accounts, and is not concealed; and
- Determine that the initiative for the gift originated from the *foreign official*.

**4.4.4 Transactions with authorities**

Doing business with governments or other authorities may involve the risk of official corruption. The auditor can perform audit procedures, including the following:

**Examples of possible audit procedures:**

- Select the public-sector companies in the accounts payable/accounts receivable and perform a test on the income/expenses relating to these contracts;
- In this regard, examine the offer process (including an assessment of whether there was an adequate division of duties), the authorisation of the contracts, special contractual terms, etc.;
- Match the contractual arrangements with the costs included in the accounts on the basis of invoices;
- If applicable, request a list of licences and permits and check how these were granted. Also pay attention to the issue of facilitating payments.
- If there are risks with regard to officers in vulnerable positions, audit procedures can be performed in relation to ancillary positions (based on public sources) and a relationship can be established whether companies linked to the person appear elsewhere in the accounting records.

**4.4.5 Cash payments**

Corruption can occur through cash payments, also because cash transactions leave fewer 'traces' in the accounting records. The auditor can perform audit procedures, including the following:

**Examples of possible audit procedures:**

- Analyse the client's policy with regard to cash payments and cash withdrawals, paying particular attention to the sources of cash transactions, for example the creation of false invoices and not (fully) accounting for the receipt and withdrawal of cash;
- Peruse cash payments, paying particular attention to the approval process for and substantiation of cash payments based on adequate documentation;
- Analyse movements in bank accounts relating to cash withdrawals, paying particular attention to the approval process for and substantiation of cash withdrawals and how these withdrawals are accounted for.

**4.4.6 Travel and accommodation expenses**

The 'travel and accommodation expenses' accounts may include corruption-related expenses because:

- 1 Corruption payments are included as travel and accommodation expenses in the accounts;
- 2 Travel and hospitality expenses (hotel expenses, dinners, client entertainment, etc.) that the client has incurred to influence potential customers can be included under this item these accounts in the accounting records; It may be important for the auditor from the perspective of the corruption risk to critically analyse the client's travel and accommodation expenses.

The auditor can perform audit procedures, including the following:

**Examples of possible audit procedures:**

- Analyse the client's policy and procedures concerning travel and accommodation expenses;
- Analyse the travel and accommodation expenses for particular accounts, looking among other things at the recipient, the extent of the travel and accommodation expenses, the place where the services have been enjoyed, the connection to any concluded contracts, etc.;
- Based on a test, reconcile the recorded costs to adequate, underlying documentation.

**4.4.7 Procurement, including tender processes and the risk of kickbacks**

A corruption risk may occur in the purchase process where the buyer agrees higher purchase prices with suppliers and then receives what is known as a kickback payment in his personal capacity. The supplier may facilitate such a kickback payment via a credit note to an entity that is linked to the buyer. An entity that is linked to the buyer may also send an invoice to the supplier for 'services rendered', for example. In relation to this risk, the auditor has no access to/use of the accounting data of the supplier and/or the employee's private entity. In addition to relying on the client's internal controls, the auditor can perform the following audit procedures:

**Examples of possible audit procedures:**

- Examine how a supplier has been chosen and whether any applicable statutory or internal tender laws and regulations and/or offer procedures have been met;
- In-depth analytical procedures relating to the recorded cost of the purchases, including a price comparison between different suppliers;
- Based on a test, reconciling the recorded costs to adequate, underlying documentation;
- With respect to key purchasing officials, investigating for any ancillary positions or establishing a link with the assessment of internal control relating to ancillary positions;
- Request suppliers to provide representations regarding any payments to an entity that is linked to a buyer.

**4.5 Requesting to provide written representations**

Under Standard 580, the auditor is responsible for requesting management and, where relevant, those charged with governance, to provide written representations. These must state that all known cases of non-compliance or suspected non-compliance with laws and regulations have been brought to the auditor's attention.

An internal or external legal adviser can also be requested to provide a list of all claims and litigations, including those arising from corruption. If there is any external investigation into corruption, this investigation forms an indication of non-compliance with laws and regulations and fraud for the auditor, who then deals with it in accordance with Dutch Standards 250 and 240, see [Chapter 5](#).

## 5 Procedures relating to an indication of corruption

Any indication of corruption also involves an indication of fraud and the auditor will therefore perform additional procedures. Holding technical consultations and/or adding a forensic expert to the audit team is recommended in these types of situations.

This chapter deals in detail with the procedures to be performed by the auditor if there are indications of corruption during the audit.

### Example:

An auditor has a construction company as a client. The company has acquired an advantageous contract to build a sports complex. However, a whistleblower has reported that a municipal official 'gave the company a helping hand' by passing on information in exchange for money. This forms an indication of corruption and fraud.

If the auditor comes across indications of non-compliance of his client with laws and regulations in his audit, it is up to him to follow a number of steps under Dutch Standard 250 and Dutch Standard 240. These steps can be summarised as follows:

- To investigate (further) in order to be able to verify the indication.<sup>48</sup> Such an investigation may consist of further examination of the accounts (e.g. in the project accounting records or specific expenses accounts), analytical procedures and/or interviews. In this way, the auditor obtains as many answers as possible to the following questions:
  - Has there been non-compliance of the client with any law or regulation?
  - What is the nature and extent of the violation?
  - Has this been isolated or structured non-compliance?
  - Do the violations seem to have been intentional or unintentional?
  - Has management been involved in the violations?
  - What is the (potential) impact on the financial statements?
- Communicate the indications to the client's management and/or those charged with governance in order to obtain more information.
  - If it seems as though the violations have been unintentional (errors), discussing them is generally easier than when there seem to have been intentional violations.
  - If the auditor suspects that management has been involved in (intentional) violations, he will discuss this at the right level within the client (for example those charged with governance). In these cases, it may be appropriate to obtain legal advice as a means to determining the appropriate course of action. The same line as in the Dutch Standard 240 is followed in this regard.<sup>49</sup>

### Example:

Based on the indication, the auditor of the construction company performs additional procedures. Among other things, he performs a test of details on the project accounting records of the sports complex, examines whether the municipal tender procedure was followed, holds interviews with project leaders, the whistleblower, if possible, and the persons responsible for contract acquisition.

When performing the additional procedures, the auditor can also rely on (internal) investigations that other parties have carried out (forensic investigation and/or a third-party investigation). If the additional investigation is performed by third parties, it is important for the auditor:

- To determine whether the engaged party is competent and objective;
- To be involved in determining the scope and procedures of this additional investigation with a view to its suitability for the auditor's purposes;
- To be able to obtain an understanding of the findings from this additional investigation.

If these additional procedures do not show that there has been any violation of laws and regulations, the auditor will document that in his file. With his suspicions refuted, he can continue his audit

<sup>48</sup> See the Dutch Standard 250, including paragraph 18, in conjunction with A13 and A14.

<sup>49</sup> See the Dutch Standard 240, including paragraphs 40, 41, 42, in conjunction with A60 to A66.

engagement as usual.

If the additional procedures do not produce any further information, the auditor will evaluate if alternative audit procedures are still possible, such as a detailed analytical procedure and/or tests of details on similar construction projections. If that is the case, the auditor will also perform these procedures. If the (final) conclusion is that there is a lack of sufficient appropriate audit evidence (for example, because those involved have not cooperated) about the indications of corruption, the auditor will document this and evaluate the impact of this inability to obtain sufficient appropriate audit evidence. The auditor will report the facts and circumstances concerning this indication to the appropriate level within the client. The auditor will also examine whether there are possible consequences for (any modification to the opinion in) his audit report, see [Chapter 6.4](#).

However, if it is clear from the additional procedures that the indications of violations are supported by the facts of the additional investigation, the auditor will document this and reach the conclusion that there is a reasonable suspicion of corruption. This has important consequences for the rest of his audit engagement.

- The auditor will examine the implications for his audit as regards the audit strategy, the audit and performance materiality, communication with those charged with governance, and the possible consequences for evaluating the integrity of management: the auditor will evaluate whether the established violation has consequences for the risk assessment of other parts of the financial statements;
- The auditor may deem it appropriate to request the client to obtain legal advice on the basis of the factual findings<sup>50</sup> and will evaluate the consequences of the established violation in the context of the annual report (for example whether provisions or disclosures have to be made in the financial statements);
- The auditor will request the client to draw up a redress plan in order to redress the established corruption, as well as to adopt measures so as to avoid any future repetition.

If the client's management is involved in the (indications of the) corruption, the auditor will discuss this with those charged with governance.

The above processes are clearly time-consuming. As a result of this, the auditor may face increased pressure to complete his audit and issue his auditor's report on time. Time pressure may never be the guiding principle. The careful handling of the (indications of) irregularities is not only in the auditor's interest – in order to obtain sufficient appropriate audit evidence for his auditor's report – but is also in the client's interest.

Situations may arise in which additional investigations into possible corruption are not yet completed, as a result of the long-term/multi-year nature of the investigation. In that case, the auditor will examine interim findings, management's assessments and any provisions and/or disclosures made by management in the financial statements on that basis. The different situations and consequences for the auditor's report are discussed in [Chapter 6.4](#).

A particular situation arises if there are indications that the management may have been involved in corruption: the auditor will generally examine whether the audit can be continued and/or completed. In this case, the auditor will consult colleagues<sup>51</sup> to determine, among other things, whether completion of the audit is still possible under the given circumstances and even obtain legal advice himself on, among other things, whether or not to terminate the audit engagement early.<sup>52</sup>

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<sup>50</sup> The Dutch Standard 240, paragraphs 40-42; the Dutch Standard 250, paragraphs A2 and A16.

<sup>51</sup> Within his own audit practice or, where possible, at the professional body.

<sup>52</sup> See the Dutch Standard 240, including paragraph 38, in conjunction with A54 to A57.

## 6 Communicating findings of (risks of) corruption

### 6.1 General

Various standards relate to communication between the auditor and the client. These specifically include:

- Dutch Standard 260: deals with the responsibility of the auditor in relation to communication with those charged with governance;
- Dutch Standard 265: discussing deficiencies in internal control.

The auditor will communicate in relation to his audit procedures regarding corruption-related risks and indications in different phases of the audit depending on his findings. The following findings will be dealt with in more detail below:

- 1 corruption-related risks and recommendations with regard to governance;
- 2 reporting on possible corruption-related violations;
- 3 possible consequences for the auditor's report;
- 4 other:
  - obligation to report under [Article 26 Wta](#) (see [Chapter 1.2](#));
  - obligation to report under the [WWFT](#) (see [Chapter 1.2](#));
  - any obligations to report on the basis of other law and regulation, such as AFM-regeling Incidentenmelding, see [Chapter 1.2](#).<sup>53</sup>

In general, the auditor will always evaluate the level at which he will report his findings within the client (depending on the facts and circumstances).

### 6.2 Corruption-related risks and recommendations with regard to governance

Through planning and audit procedures, the auditor can identify relevant risks and deficiencies in the internal control to be reported to the client. Some examples of recommendations to improve internal control include:

- the client conducts a risk analysis in relation to corruption;
- the client formulates an anti-corruption policy;
- the client implements an anti-corruption policy by:
  - developing the right 'tone at the top', through training and other means;
  - making employees assertive through anti-corruption training;
  - screening third parties, including agents;
  - implementing policies for contracts with and invoices of agents;
  - implementing procedures for ancillary positions (to prevent conflicts of interest); or
  - implementing procedures for business gifts and entertainment.
- the client performs activities to monitor compliance with the implemented measures.

### 6.3 Reporting on possible corruption-related violations

As stated in [Chapter 5](#) of this Practice Note, the auditor will perform, or arrange for the performance of, additional procedures when there are indications of corruption. This is aimed at the question whether the auditor is able to confirm that, or is unable to conclude whether, the financial statements are materially misstated as a result of corruption (and overlaps with fraud).<sup>54</sup> During the performance of those procedures, the evaluation is made on the basis of the Dutch Standard 240.

After the completion of these additional procedures, the auditor will report on his findings to the client (preferably in writing)<sup>55</sup>, for example as part of his additional report to those charged with governance. Standard 260 contains guidance on when written communication is appropriate, for example as a way to summarise and supplement previous verbal communication.

In this report, the auditor may pay attention, among other things, to the following topics, on the understanding that the content of [Chapter 6.3.3](#) is compulsory:

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<sup>53</sup> Any other obligations to report, such as under the Wet op het financieel toezicht (Wft, Dutch Financial Supervision Act) are not taken into consideration.

<sup>54</sup> See Standard 240, paragraph 37.

<sup>55</sup> In accordance with Standard 260.

### 6.3.1 *Objective and scope of the additional procedures*

It is important to clearly state that the investigation is being performed as part of the audit of the financial statements. It is up to the auditor to deal carefully in the wording with possible personal aspects in relation to individuals (Also see NBA-handreiking (Practice Note) 1112).

### 6.3.2 *Procedures performed*

The auditor clearly indicates which procedures he has performed. If the auditor uses investigative work performed by other parties (a law firm, for example), the auditor is responsible for documenting that the investigative work by that third parties complies with the requirements set for that purpose.

### 6.3.3 *Findings and conclusion as part of the audit of the financial statements*

The auditor will report his factual findings from the additional procedures to the client and formulate a conclusion, based on those factual findings, in light of the audit of the financial statements. In this communication with the client, the auditor will generally formulate a conclusion as to whether there is a reasonable suspicion of fraud (and overlapping corruption) or of the violation of law and regulation. If there is fraud, or a reasonable suspicion of fraud, the auditor shall formulate his conclusions in that regard on the basis of the Dutch Standard 240. In that situation, the auditor will accordingly insist that the client:

- Redresses the fraud (and overlapping corruption);
- Produces a substantiated plan to prevent such an issue again in future.

Redress can include:

- Measures against the employees concerned;
- Measures against the third parties concerned (ending the contractual relationship);
- Informing the relevant parties;
- Where possible, reversing the transaction and its consequences.

The auditor will also evaluate possible risks/obligations arising from the violation of law and regulation (e.g. risks of claims or fines) for treatment or disclosures in the financial statements. The auditor can refer further in his report to the correct treatment/disclosure in the financial statements.

If the additional investigation provides no clarity in this regard, the auditor will reach the conclusion that there is only an indication that could not be substantiated any further.

## **6.4 Possible consequences for the auditor's report**

Based on the additional procedures performed, the auditor will evaluate the findings in light of the auditor's report to be issued. The auditor will mainly consider whether the violation of corruption-related law and regulation can lead to issues relating to uncertainties in the accounting and/or the inability to obtain audit sufficient and appropriate audit evidence. This applies insofar as the client assumes its responsibility to redress the issue in the financial statements and adopts measures to prevent any repetition in the future.

- It is possible, for example, that the client will not adequately disclose an uncertainty in the annual report, such as the outcome of legal action concerning a transaction with a third party or a supervisory authority, which could possibly be regarded as a material misstatement due to qualitative aspects, and lead to a qualified audit opinion.
- It is also possible that the auditor is unable to obtain sufficient appropriate audit evidence about an underlying transaction in the annual accounts. Based on qualitative aspects, the auditor may find the possible effects of the matter to be material and choose to express a qualified audit opinion.
- If the matter above is found to be pervasive, the auditor may express an adverse audit opinion or a disclaimer of opinion.

The auditor will assess these issues on the basis of the Dutch Standard 705. The auditor may also consider to express findings on corruption, and risks of corruption, in his auditor's report in accordance with the Dutch Standard 706 or the Dutch Standard 700. The Dutch Standard 700, for example, requires public-interest entities (PIEs), and gives the option to non-PIEs, to include so-called 'key audit

matters'. Examples of this can be found on the NBA website.<sup>56</sup>

If the client does not wish to disclose material uncertainties in the annual report, or does not wish to include provisions that are deemed to be necessary, the auditor will determine whether this situation:

- constitutes a threat to the fundamental principles that he is required to comply to;<sup>57</sup>
- activates the obligations to report under [Article 26 Wta](#) and/or the WWFT, see [Chapter 1.2](#);
- possibly leads to a material misstatement in the annual report with consequences for the nature of the auditor's report to be issued.

The Dutch Standard 720 applies to the content of the management report or any other information in the client's annual report when the client reports or does not report therein, on the basis of RJ-Richtlijn 400 (see [Chapter 1.1](#)) among others, on the main risks and uncertainties relating to corruption.

The auditor may obtain (legal) advice in this regard, if necessary.

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<sup>56</sup> See [https://www.nba.nl/Documents/Wet-%20en%20Regelgeving/Adviescollege%20voor%20Beroepsreglementering/Praktijkvoorbeelden\\_kernpunten\\_van\\_de\\_controle\\_2013\\_20141017.pdf](https://www.nba.nl/Documents/Wet-%20en%20Regelgeving/Adviescollege%20voor%20Beroepsreglementering/Praktijkvoorbeelden_kernpunten_van_de_controle_2013_20141017.pdf).

<sup>57</sup> Information of a client may be materially inaccurate, incomplete or even misleading if disclosures (on corruption) are omitted. If an auditor is associated with such information, this can affect the fundamental principle of integrity that he is required to comply with. See the reference in Chapter 1.2 to the VGBA, including paragraph 2.3.

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