



14 December 2012

Our ref: ICAEW Rep 184/12

Ken Siong
Acting Deputy Director
IESBA

By email

Dear Ken

Responding to a Suspected Illegal Act

ICAEW is pleased to respond to your request for comments on *Responding to a Suspected Illegal Act*.

Please contact us should you wish to discuss any of the points raised in the attached response.

We look forward to the opportunity to respond to any revised proposals.

Yours sincerely

Iain Lawson

Chairman, ICAEW Ethics Standards Committee



ICAEW REPRESENTATION

RESPONDING TO A SUSPECTED ILLEGAL ACT

Memorandum of comment submitted in December 2012 by ICAEW, in response to IESBA exposure draft 'Responding to a Suspected Illegal Act' published in August 2012.

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the exposure draft *Responding to a Suspected Illegal Act* published by IESBA on August 2012, a copy of which is available from this [link](#).

WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 138,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

MAJOR POINTS

4. We believe that it is wholly right and proper for the IESBA code of ethics (the code) to encourage disclosure of actual or suspected illegal acts where the public interest in disclosure would outweigh the professional duty of confidence. There is a clear public interest in those who perpetrate illegal acts being brought to account. However, that decision must be a matter of professional judgement for the professional accountant: circumstances and the factors involved in the assessment are highly variable and frequently complex.
5. We cannot support the inclusion of an absolute requirement to disclose, within a global code of ethics. While the proposal might seem to be in the public interest at first sight, once the practicalities and complexities of real life are recognised, it is likely not to achieve its aim and, indeed, to have unintended consequences. For example:
 - 5.1. There is also a public interest in potential clients and employers being able to confide in the professionals whose services they need. If it is generally thought that professional accountants would be required to disclose suspected illegal acts, those who would intentionally break the law will withhold information, making the accountant's job more difficult, or will use the services of others, who do not have a disclosure obligation. Those who have strayed inadvertently will hesitate to confide in the professional accountant, thus reducing the likelihood of the illegal act being avoided or at least mitigated.
 - 5.2. Reporting a suspected illegal act that turns out not to be the case could leave open the accountant to significant legal liability. It is therefore potentially likely that a significant amount of work would need to be undertaken by the professional to establish the likelihood that the suspected illegal act has actually taken place. This might tip off the perpetrator.
 - 5.3. The reporting of illegal acts is addressed by many countries' national laws, requiring particular disclosures in particular circumstances. Legislators make national public interest decisions when determining these required disclosures. The interaction of these requirements with a requirement in the code will make application very complex, especially in cross-border situations. There are many differing cultural attitudes as to whether public interest can transcend the law and many layers of confidentiality (eg ethical, data protection, banking secrecy, legal privilege) and different implications of breaching these. In law, the reporting circumstances are well defined, take into account the likely authorities to be reported to and what action they could take, and are often attached to confidentiality protection.

6. The decision must remain with the professional accountant. Determining whether something is or is not in the public interest is very complex- ICAEW has recently published a paper [*Acting in the public interest: a framework for analysis*](#)¹ which illustrates the issues involved. Only the professional involved is going to be in a position to be able to make the assessment as to whether disclosure would override the duty of confidence to the potential client or employer, that is inherent in the fundamental principle of confidentiality.
7. In preparing this response we carried out our own consultation and received responses from members engaged in a wide variety of activities. One uniform feedback to us was in respect of the obligation applicable to professional accountants other than those providing services to audit clients: respondents were unclear as to the intent behind being given a right to disclose, which the code then observes they would be 'expected to exercise'. This appears to be attempting to impose an obligation and the relevant wording needs to be addressed.
8. As well as further discussion on when the accountant might consider an override of the duty of confidence, we would support the inclusion in the code of guidance for professional accountants as to what not to do in the face of suspected illegal activity. For example, it could clarify that a professional accountant cannot assist the client or employer in carrying out illegal acts, cannot merely turn a blind eye to suspected significant illegal activity (including resigning an audit without comment) and should consider if and how the matter should be reported internally to the organisation.

RESPONSES TO SPECIFIC QUESTIONS

9. As noted above, we do not agree with the inclusion of an absolute requirement to report to authorities, within a global code of ethics, as we believe it will be counter-productive. We have proposed an alternative approach to guidance. In that context, a number of the detailed questions posed in the IESBA consultation paper become irrelevant. However, we have answered each question to assist in informing IESBA, should it adopt a closer approach to that currently proposed.

Q1. Do respondents agree that if a professional accountant identifies a suspected illegal act, and the accountant is unable to dispel the suspicion, the accountant should be required to discuss the matter with the appropriate level of management and then escalate the matter to the extent the response is not appropriate? If not, why not and what action should be taken?

10. Subject to our comments in paragraph 9 above, we agree, but with caveats to ensure there are not unintended consequences. In determining what 'reasonable steps' to confirm or dispel suspicion might involve, the accountant is going to need to take into account a number of issues. For example:
 - 10.1. Substantial work and personal cost may be required just to establish the "likely scale" of the occurrence: if this is for a potential client or employer the difficulty and cost may be substantially increased. The amount of effort ought to be proportional to the likely scale of the issue or the amount of work could be unreasonable. However, this could risk missing items which appear to be minor but prove otherwise.
 - 10.2. Investigation to determine whether there are grounds for the suspicion could result in tipping off the perpetrator.
 - 10.3. Investigation could also put the accountant in direct danger as those being reported to may be parties to the act.

¹ Also available at www.icaew.com/ethics

10.4. The extent to which the matter falls within the accountant's expertise will be relevant to the degree to which investigation may need to be carried out – see our comments under question 7 below.

11. It is sometimes unclear what is illegal. For example, there are different definitions of illegal acts in different jurisdictions and even within one, the issue can be debatable (for example tax avoidance, particularly where there is a general anti-avoidance rule).
12. It would, in practice, be difficult for the accountant in employment to determine if a matter has been dealt with properly by those in more senior positions in the employing organisation, if he or she holds a relatively junior position. This person may not have sufficient facts to make a determination in any event.
13. Taking reasonable steps to confirm or dispel suspicion may therefore prove to be fraught with problems. The draft wording addresses the issue of doubts about whether the potential reportees are involved but does not otherwise seem to consider the possibility that the accountant simply may not be able to confirm or dispel suspicion.
14. The code envisages scenarios where someone within the client or employer is the perpetrator. Would it require the accountant to investigate matters to the same extent where the client/employer is the potential victim?

Q2. Do respondents agree that if the matter has not been appropriately addressed by the entity, a professional accountant should at least have a right to override confidentiality and disclose certain illegal acts to an appropriate authority?

15. We agree with that professional accountants should be encouraged to make disclosure where they consider that the public interest in disclosure outweighs their professional duty of confidence, and local law permits it. The code says little on this at present. Additional wording need not be lengthy. An example is ICAEW's [own additional wording](#) in an add-on to paragraph 140.7² in its code of ethics. We also believe that it is right to clarify that resignation/disassociation is no substitute for disclosure.
16. The exposure draft proposals refer to a right. However, a number of respondents to us commented that a right implies something granted by law. The code cannot give a legal right. What is being considered here is under what circumstances it would be appropriate for the professional accountant to override the fundamental principle of confidentiality, within the boundaries of the relevant legal framework.
17. Paragraph 225.2 of the draft does allude to the requirements being subject to national law. Although this is a general condition of the code it is particularly critical here. The interaction with national law will be complex (and not just for auditors: for example in the UK there are special reporting requirements which include anyone providing accountancy services). The paragraph only gives an example of where the law would require disclosure: we are aware that, for instance, there are many countries where laws forbidding disclosure are much stronger than in the UK and other examples should be included.
18. National law may make professional privilege available. If this is permitted but not required, what prevails: a confidentiality privilege that local legislators have made available, presumably in the public interest, or a disclosure requirement in the code, included for the same reason? We assume that it should be the former, as national legislators are likely to be in a position to be able to make a more detailed assessment of the public interest in their jurisdiction, taking into account local issues, than IESBA inevitably can, in an international code.

² Also available at www.icaew.com/ethics

19. We do not agree that there should be an absolute obligation to disclose, within a global code of ethics. While we assume that this is not what IESBA intends, other than for those providing services to audit clients, our members responding to our consultation got the impression that by being given a right to disclose which they were then 'expected to exercise' the wording was trying to impose a requirement in a roundabout manner. An obligation of this nature is suited to law, not an ethical code based on threats to personal ethical behaviour. In our view it would also be counterproductive, reducing the likelihood of preventing and detecting illegal acts:

19.1. It may discourage openness by clients and employers, causing professionals difficulty in doing their job to a professional standard (which is the point of professional privilege in many countries for lawyers, priests and medical practitioners among others), or in persuading the client/employer/colleague to minimise illegality.

19.2. Those setting out to subvert the law will merely ensure that accountants are kept at a distance and use the services of others who do not have a reporting obligation.

19.3. A requirement to disclose would cause significant problems for, for example, forensic accountants, rescue and recovery professionals or accountants acting as expert witnesses in legal proceedings, given the nature of many of their engagements.

19.4. A requirement would also cause problems for accountants working for law firms and other multi-disciplinary practices, in the event of a conflict of codes.

Q3. Do respondents agree that the threshold for reporting to an appropriate authority should be when the suspected illegal act is of such consequence that disclosure would be in the public interest? If not, why not and what should be the appropriate threshold?

20. The basic consideration for overriding a fundamental principle can only be a public interest duty: there should be disclosure if the public interest in disclosure outweighs the professional duty of confidence. However, making such a determination could put the accountant in an impossible situation: different people will have different views, including reasonable and informed third parties. This is particularly so in cross-border situations: different cultures have different ideas about the public interest.

21. It is a lot easier to determine public interest after the fact: human nature being what it is, the accountant could be open to hindsight criticism for non-disclosure. Consider examples: (a) of a construction company where there is a failure to follow health and safety, or (b) of a client's car being seen with a bald tyre: in each case these are likely to be minor offences but could be potential killers.

22. There will also be an interaction with national legislation on, eg whistleblowing, where there may be different reporting thresholds.

23. These illustrate the difficulties in making a public interest determination: given the variable circumstances, only the professional can make that determination and whether he or she needs to make a disclosure.

Q4. Do respondents agree that the standard for a professional accountant in public practice providing services to an audit client should differ from the standard for a professional accountant in public practice providing services to a client that is not an audit client? If not, why not?

24. No. We agree that an audit does have some different characteristics from other services:

24.1. The auditor is appointed to report to shareholders - already a form of public reporting;

24.2. It is a service imposed by law, whereas most other services are contractual. That is why law often distinguishes reporting duties for auditors from others.

24.3. The relevant public (see [*Acting in the public interest: a framework for analysis*](#)³) is likely to be wider for many audits than for most contractual services.

25. However, the discussion paper does not clearly justify why these characteristics should result in a different level of imposed requirement. The code applies the same fundamental principles to all professional accountants. The basic public interest/professional duty of confidence equation is the same, albeit auditors may consider that a different balance applies and the factors to be considered by accountants in different roles may be different (see our comments on question 7 below). That must be for their judgement however as an absolute requirement cannot cater for all likely circumstances.

Q5. Do respondents agree that an auditor should be required to override confidentiality and disclose certain suspected illegal acts to an appropriate authority if the entity has not made adequate disclosure within a reasonable period of time after being advised to do so? If not, why not and what action should be taken?

26. No. As explained above, we believe that a requirement in the code to make external disclosure would not achieve greater disclosure and prevention of illegal acts because of the likely change in relationship and openness with the accountant, liability concerns leading to excessive work on assessing suspicion (and possible tipping off), and the complex interaction with national laws and other codes.

27. All of these apply just as much to accountants providing audit services as others. In terms of openness, we are concerned with the effect this might have on particular types of audit work. For example, businesses being audited might be very reluctant to give an auditor full access to a risk register.

28. Auditors are often given additional reporting requirements in respect of various matters in national law. Where legislators choose not to impose reporting requirements, they may be doing so at least partly on issues of civil rights and ensuring proper enquiry due process. Imposing additional requirements over and above this may circumvent that due process by national authorities.

29. Of particular relevance to auditors would be what action is required in respect of cross-border clients or travels by the accountant, in respect of an act which would be illegal in one place, but not another. It is not impossible to imagine a scenario in which an auditor from one country is working on the audit of a branch in another country and suspects what may be an illegal act has taken place in a third country. This adds to complexity in determining whether the act is illegal, and which the appropriate authority is, particularly where countries are involved whose authorities have extraterritorial ambition.

30. On the subject of identifying the appropriate authority, a concern was raised by some of our respondents as to where the accountant's responsibility stops. If the authority that the accountant thought was the appropriate one did not appear to take reasonable action, would this indicate that the authority was in fact not the appropriate authority, implying a need to report it elsewhere?

31. In summary, therefore, we do not agree that it is in the public interest to include within the code, a requirement (rather than a right) to disclose to an appropriate authority. As noted in our comments on question 4 above, audits do have different characteristics than many other services but this, if anything, would mean that a different assessment might be made by the

³ Chapter 5.

professional as to where a public interest disclosure would outweigh the duty of confidentiality. It does not warrant a differential treatment in terms of obligation to disclose within the code.

32. We do support the inclusion of more discussion on when professional accountants might consider it appropriate to override the duty of confidentiality, and guidance for accountants as to what not to do in the face of suspected illegal activity. Further detail on this is included in paragraph 8 above. Such discussions might include an encouragement to auditors to explain why they resigned, which would deal with the concern in some quarters that auditors walk away rather than face up to illegal acts. This is included in legislation in some countries, including for example the UK and, going forward, Singapore.

Q6. Do respondents agree that a professional accountant providing professional services to an audit client of the firm or a network firm should have the same obligation as an auditor? If not, why not and what action should be taken?

33. Yes, in as much as we believe that all professional accountants should be able to override the duty of confidentiality when they judge it to be in the public interest, rather than being obliged to disclose, as discussed above. However, if the different characteristics of an audit, discussed above, were to merit a differential level of disclosure requirement, the matter becomes more complex.
34. If the other services are provided by the audit team, the matter becomes irrelevant. However, as is frequently suggested by s290 of the code as a safeguard, the other services will often be provided by a separate team, with separate reporting lines and a separate engagement letter. In those circumstances, if the non-audit service engagement partner considers the suspected illegal act might impact on the audit, he or she will have to take a decision taking all relevant issues into account. But in terms of whether there should be a requirement in the code, there can be no logic in distinguishing between, say, one set of non-audit services to an audit client and another, by the same (non-audit) staff, to a non-audit client.

Q7. Do respondents agree that the suspected illegal acts to be disclosed referred to in question 5 should be those that affect the client's financial reporting, and acts the subject matter of which falls within the expertise of the professional accountant? If not, why not and which suspected illegal acts should be disclosed?

35. In principle, any disclosure (subject to the law) should be on any matter where the accountant considers that the public interest demands that disclosure would outweigh the duty of confidence. In the context of an ability to disclose rather than an obligation, any restriction would not fit with the public interest rationale and is unnecessary.
36. Whether the matter is within the expertise or remit of the accountant is relevant in the context of an ability to disclose, but more in discussing the extent of determination of the degree of understanding required in the first place to have a reasonable suspicion. Where there is an obligation or expectation that there may be disclosure, accountants should be quite certain that they understand what is going on. This is naturally more likely to be easier where the matter falls within their area of expertise – where it does not, they are in no different position to any other citizen. We therefore suggest that the issue of the nature of the suspected illegal act be moved to a discussion on the level of suspicion. This would also deal with circumstances where it is unclear whether the matter does fall within the accountant's remit – for example, if the potential issue related to something the accountant does not personally deal with but another firm was carrying out diligence on, the current draft is unclear as to the action required.
37. Were IESBA to continue to believe that an obligation should be imposed on accountants providing services to audit clients, the matter becomes more complex. Any obligation should

be restricted to matters within the accountant's area of expertise (likely to relate to financial reporting, but not always) as those matters are the ones in which the accountant should have greater insight than others. As regards other matters, the professional accountant should be in the same position as regards overriding confidentiality, as anyone else within the relevant territory.

Q8. Do respondents agree that a professional accountant providing professional services to a client that is not an audit client of the firm or a network firm who is unable to escalate the matter within the client should be required to disclose the suspected illegal act to the entity's external auditor, if any? If not, why not and what action should be taken?

- 38.** If the matter has a bearing on the subject of the audit, then it would clearly be appropriate for the accountant to be encouraged to inform the auditor. However, for reasons noted above, we believe that a requirement to report externally would be counterproductive. Although matters likely to be discovered by accountants would probably be at least potentially relevant to the audit, if the matter were not relevant to the audit, a requirement is even less appropriate.
- 39.** Other than considering the impact on the audit directly, it is unclear to us what the auditors are supposed to do with such a report. Presumably, the auditor must now make an assessment of whether the matter is a public interest one. If it is thought to be, the matter is now brought into the 'must be reported (by the auditor)' category, as drafted. This is inconsistent with the position if there is not an auditor (which is likely to be the case for most businesses around the world, by number if not size).
- 40.** If the auditor reports to certain authorities involved with, eg, anti-money laundering, they may not be able to feed back that they have made a report. As a practical matter, this will make it difficult for the accountant to determine if the matter has been dealt with properly.

Q9. Do respondents agree that a professional accountant providing professional services to a client that is not an audit client of the firm or a network firm should have a right to override confidentiality and disclose certain illegal acts to an appropriate authority and be expected to exercise this right? If not, why not and what action should be taken?

- 41.** We agree with an ability to override confidentiality (within the boundaries of the relevant legal framework). Indeed, the accountant should be encouraged to make disclosure where he or she believes that the public interest in disclosure outweighs the professional duty of confidence. However, we have major concerns with the wording as drafted. It is quite unclear what a 'right' that the accountant is 'expected to exercise' actually means. We assume that it is not intended to be an obligation, given the different wording used elsewhere, but it appears to be more than encouragement: an obligation by a roundabout route. We believe that this wording would be difficult for members to interpret and professional bodies to know how to enforce. It could increase the need for legal advice unnecessarily and should be amended..

Q10. Do respondents agree that the suspected illegal acts to be disclosed referred to in question 9 should be those acts that relate to the subject matter of the professional services being provided by the professional accountant? If not, why not and which suspected illegal acts should be disclosed?

- 42.** As question 7.

Q11. Do respondents agree that a professional accountant in business who is unable to escalate the matter within the client or who has doubts about the integrity of management

should be required to disclose the suspected illegal act to the entity's external auditor, if any? If not, why not and what action should be taken?

43. As question 8.

Q12. Do respondents agree that a professional accountant in business should have a right to override confidentiality and disclose certain illegal acts to an appropriate authority and be expected to exercise this right? If not, why not and what action should be taken?

44. As question 9.

45. We are particularly concerned that in many organisations where there might only be one professional accountant and therefore anything that implies an obligation would have the effect of turning the CFO (the most likely role for the accountant) into the internal whistle-blower. That may be how the organisation wishes to arrange matters but equally, it should be free to make other arrangements where circumstances dictate.

Q13. Do respondents agree that the suspected illegal acts to be disclosed referred to in question 12 above should be acts that affect the employing organization's financial reporting, and acts the subject matter of which falls within the expertise of the professional accountant? If not, why not and which suspected illegal acts should be disclosed?

46. As question 7.

Q14. Do respondents agree that in exceptional circumstances a professional accountant should not be required, or expected to exercise the right, to disclose certain illegal acts to an appropriate authority? If not, why not and what action should be taken?

47. As noted in paragraph 9, we do not agree with the inclusion of a requirement in a global code of ethics. We agree that professional accountants should be able to override the duty of confidentiality where they judge it to be in the public interest to do so, where the law permits it. However, in that context the exceptional circumstances are really part of the determination of whether disclosure is in the public interest.

48. The factors that can be taken into account would need to be explained in more detail for an obligation, where any exception can be seen as an opportunity to circumvent the requirement, than for an ability to disclose, where it is (and should be explained as being) actually guidance on matters for the accountant to consider in making the determination of the disclosure/confidentiality balance.

Q15. If respondents agree that in exceptional circumstances a professional accountant should not be required, or expected to exercise the right, to disclose certain illegal acts to an appropriate authority, are the exceptional circumstances as described in the proposal appropriate? If not, how should the exceptional circumstances be described?

49. The fundamental principles in the code already require accountants to put duty ahead of self-interest. Exceptional circumstances should focus on significant threats to personal well-being, including the likelihood of protection by the authorities.

Q16. Do respondents agree with the documentation requirements? If not, why not and what documentation should be required?

50. Other than in respect of matters related to compliance with auditing regulation, the code generally advocates documentation as being in the interests of the accountant but does not require it. The proposals seem to be at odds with this, and disproportionate, given that there is no de minimis threshold at the start of the process. It should be sufficient to advocate the maintenance of 'appropriate' documentation.
51. This would also deal with a concern that, if the accountant is subject to legal action in respect of a reported suspicion, the documentation may be legally discoverable in some jurisdictions.

Q17. Do respondents agree with the proposed changes to the existing sections of the Code? If not, why not and what changes should be made?

52. On the whole, yes. However, we have some concerns about the redrafting of paragraph 150.1 relating to association:
- 52.1. 'association' is potentially very broad in application. It could be interpreted as preventing professional accountants being employed by any organisation who has ever undertaken a questionable act. Preventing accountants associating with those who act unethically may prevent them being able to eliminate or minimise the act. That would not be in the public interest.
- 52.2. 'unethical acts' is also unclear. Would ethical behaviour be measured in line with a corporate/professional code, or against personal values?

Q18. Do respondents agree with the impact analysis as presented? Are there any other stakeholders, or other impacts on stakeholders, that should be considered and addressed by the IESBA?

53. The scale of the impact analysis appears to be proportionate to the scale of the matter. However, we note that while it raises as high impact issues, aspects of litigation and retaliation, the narrative in the exposure draft dismisses them as matters that only the law can solve: hardly a resolution of the problem. In addition, as will be apparent from our comments above, we believe the impact of loss of confidentiality to be significantly greater than medium.

OTHER MATTERS

54. For the avoidance of doubt it might be helpful to clarify that the guidance applies to known as well as suspected illegal acts.
55. If IESBA is considering undertaking more research on this area, given the fundamental change that the proposed amendment to the code potentially causes on the relationship between accountants and employers, we draw attention to not only ICAEW's report [*Acting in the public interest: a framework for analysis*](#)⁴, but also the UK Fraud Advisory panel's report [*Fraud reporting: a shared responsibility*](#)⁵.
56. In view of the keen interest in this complex and fundamentally important area, we hope that IESBA will re-issue whatever its revised proposals are, following assessment of the consultation responses, for further comment.

⁴ Also available at www.icaew.com/ethics

⁵ Also available at www.fraudadvisorypanel.org

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