



November 5, 2012

Via website posting: <http://www.ifac.org/ethics>

International Ethics Standards Board for Accountants
International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, New York 10017
USA

Attention: IESBA Acting Deputy Director, Mr. Ken Siong

Dear Mr. Siong:

Re: Exposure Draft: Responding to a Suspected Illegal Act

The Certified General Accountants Association of Canada (CGA-Canada) welcomes the opportunity to comment on the Exposure Draft (ED): Responding to a Suspected Illegal Act. We have also provided further remarks on other matters that are germane to this discussion which we have detailed under Additional Comments.

Question 1

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?

Response

We consider a robust code of conduct for the professional accountants *sine qua non* for establishing the credibility of the profession, and a golden rule of such code should be the primacy of public interest over self-interest. However, we believe that the professional accountant's obligation with respect to a suspected illegal act should be restricted to the acts of accounting mischiefs and financial reporting frauds, or misrepresentations for which **direct linkage** can be established between the act and the impact, and that would have a **material** financial impact. Any other types of illegal acts which may indirectly impact financial reporting are not within the natural domain of the professional accountant's core competencies and beyond the expertise of professional accountants. We believe that all illegal acts ultimately impact financial reporting directly or indirectly and we do not believe that it should be an ethical obligation of a professional accountant to suspect and report illegal acts (such as violation of building code or formation of a price fixing cartel by an entity in contravention of antitrust laws, for example).

We would like to reiterate the observations made by Lord Justice Lopes in the famous case *Re: Kingston Cotton Mills Co. (1896)*, as follows:

"It is the duty of an auditor to bring to bear on the work he has to perform that skill, care and caution which a reasonably careful, cautious auditor would use. What is reasonable skill, care and caution must depend on the particular circumstances of each case. **An auditor is not bound to be a detective, or, as was said to approach his work with suspicion, or with a forgone conclusion that there is something wrong. He is a watchdog, not a bloodhound.** He is justified in believing tried servants of the company in whom confidence is placed by the company. He is entitled to assume that they are honest and rely upon their representations, provided he takes reasonable care."

Although, these observations are made with reference to the auditors, they can be reasonably applied to all the professional accountants. Since the above-mentioned definitive judgment, there has been gradual increase in the standard of care expected from professional accountants. However, we believe that the proposals in the present ED are extreme and can metamorphose professional accountants into self-appointed moral police. We are concerned that, with the passage of time, the **"duty to respond to a suspected illegal act"** will mutate into the **"duty to suspect and respond to an illegal act"**, notwithstanding a professional's fundamental mindset for professional skepticism. We believe that such possibility is more real than imaginary, as there are known instances when professional accountants in public practice were held to higher standards of accountability.

To avoid such an outcome, we believe that the terms "suspected illegal act" and "suspicion" need to be more clearly defined within the context of the ED in order to assist professional accountants in making these determinations.

The proposals are likely to increase the expectation gap among members of the public with respect to the work of professional accountants. We believe that the unintended consequences of the present ED will be to nullify the objectives of the IAASB ED: *Improving the Auditor's Report* which is to diminish such expectation gap with respect to the work of professional accountants working as auditors. We are not aware of such onerous ethical obligations for other professionals such as lawyers who in fact enjoy the protection of privileged communication with their clients.

However, we do 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, **provided that the subject matter in question is accounting or financial reporting irregularities and is of a nature which falls within the expertise of the professional accountant, and would have a material impact on the financial reporting of the entity.**

Our responses to the other questions in this ED are without prejudice to those stated above.

Question 2

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?

Response

We maintain that a professional accountant is not an agent of the state and whether the professional accountant should override confidentiality and disclose certain illegal acts to an appropriate authority is contingent upon the legal framework of a particular jurisdiction. Under no circumstances should professional accountants violate the law of the land or contractual obligations unless such override is expressly permitted by the statutes in the relevant jurisdiction.

We recognize that these proposals may well require amendments to member bodies' code of ethics in order to permit professional accountants to make such disclosures without finding themselves offside of their respective confidentiality requirements.

Furthermore, we believe that such reporting instances should be undertaken only after appropriate consultation with legal counsel.

Question 3

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?

Response

We believe that what constitutes public interest is a highly subjective matter and can be better judged *ex-post* than *ex-ante*. As famously stated by the world's greatest investor Warren Buffett, **"In the business world, the rearview mirror is always clearer than the windshield."**

Hence prescribing a threshold in general or generic terms is not right and proper unless the term "public interest" can be clearly interpreted as being set at a very high threshold for reporting. While we appreciate the guidance offered in paragraph 225.11, it is our view that this guidance needs to be more succinct and understandable to readers.

Matters specific to professional accountants in public practice (Section 225 of the Code)

Question 4

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?

Response

We disagree with the idea of differential standards for a professional accountant in public practice providing services to an audit client and for a professional accountant in public practice providing services to a client that is not an audit client. We believe that such proposal does not

enhance the standing of the profession and degrades the value of services rendered by a professional accountant to a non-audit client. We are also doubtful if such differential standards will pass scrutiny in a court of law. We are not aware of such differential standards among other learned professions, such as medicine, and do not expect differential standards of care prescribed for cardiologists and family physicians, for example.

Question 5

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?

Response

Please refer to our response to Question 2. We believe that under such circumstances, the proper course of action for the professional accountant would be to dissociate from such client and comply with the law of the jurisdiction.

Question 6

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?

Response

As stated in our response to Question 4, we disagree with the idea of differential standards of care among the professional accountants on the basis of the nature of their work and accordingly believe that a professional accountant providing professional services to an audit client of the firm or a network firm should have the same obligations.

Question 7

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?

Response

Consistent with our response to Question 1, we agree that the suspected illegal acts to be disclosed referred to in Question 5 should be only those that directly and materially affect the client's financial reporting, and for subject matter which falls within the expertise of the professional accountant.

Question 8

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?

Response

We 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, assuming that such disclosure is not in contravention of any applicable law.

Question 9

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?

Response

We believe that the following tautology holds: **Right to Report + Expectation to Report = Obligation to Report** in so far as the instances we have detailed in response to Question 1. We are unsure what is missing from the left hand side of the equation to conclude that it implies a lower threshold than the right hand side of the equation. Again, we are not in favor of prescribing differential thresholds for professional accountants in public practice on the basis of the kind of services they are rendering to their clients and their obligations should typically remain consistent when confronted with identical situations.

Question 10

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?

Response

We strongly agree that the suspected illegal acts to be disclosed referred to in Question 9 should be restricted to only those acts that relate to the subject matter of the professional services being provided by the professional accountant. To expect otherwise would be to require client interaction to act as a "fishing expedition" or "witch hunt", rather than a professional engagement.

Matters specific to professional accountants in business (Section 360 of the Code)

Question 11

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?

Response

We do not think that the professional accountant in business enjoys special privileges relative to other professionals in business. It will be inappropriate for the professional accountant in business to assume the role of whistle blower *suo moto* without any legal requirement or immunity in a given jurisdiction. We believe that the professional accountant should make such disclosure only on specific inquiry from the external auditor or appropriate authority and, in such cases, the professional accountant should fully cooperate with the external auditor or the appropriate authority investigating such suspected illegal acts.

That said, it is unclear what route the professional accountant should take in a circumstance (as detailed in paragraph 360.6) where the entity does not have multiple levels of management, or where the entity does not engage the services of an external auditor.

Question 12

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?

Response

Please refer to our response to Question 11.

Question 13

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?

Response

Subject to the law of the jurisdiction of the professional accountant's domicile, we agree that the suspected illegal acts to be disclosed referred to in Question 12 above should be acts that materially affect the employing organization's financial reporting, and for subject matter which falls within the expertise of the professional accountant.

Question 14

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?

Response

We agree with the proposals for exempting the professional accountants from disclosures in exceptional circumstances.

Question 15

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?

Response

We consider the proposed description of the exceptional circumstances a professional accountant should not be required, or expected to exercise the right, to disclose certain illegal acts to an authority as appropriate. However, we would like to propose a **mandatory** requirement for the professional accountant to dissociate from the client or the employer, as the case may be, under such exceptional circumstances (where permitted by law).

Other exceptional circumstances, in addition to physical safety, that ought to be included in the explanatory guidance should be threats to personal property or the financial ruin of the professional accountant.

Question 16

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

Response

We agree with the documentation requirements, as such requirements defend the position taken by the professional accountant and also help in resolving any issue arising out of the ethical and statutory obligations. We believe that such documentation should include *inter alia* description of suspected illegal acts, basis of such suspicion, steps taken to escalate the matter, final resolution and, when appropriate, the reasons for not disclosing such suspected illegal acts.

Question 17

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

Response

We believe, without prejudice to our reservations regarding the desirability and appropriateness of the proposals in the present ED, that the proposed changes to the existing sections of the code are properly aligned to the objectives and the requirements of the present ED.

Question 18

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?

Response

We believe that the impact analysis as presented lacks the depth in so far as it relates to the professional accountants. For example, the analysis does not evaluate the impact of the proposals on the operational efficiency of the professional accountants or on the cost of their services to the

public. The analysis is also silent on how the conflict between the legal obligations and enhanced ethical obligations under the proposals can be resolved, thus minimizing the true impact and cost to professional accountants, and in particular SMPs. We suggest a more comprehensive evaluation of the impact of the proposals on the SMPs and professional accountants working in emerging economies.

Additional Comments

**“Although gold dust is precious, when it gets in your eyes it obstructs your vision”
- Hsi-Tang (Zen Master)**

We believe that the robustness of the ethical framework of a profession is the gold standard for judging its integrity and credibility. We would like to note that CGA-Canada’s *Code of Ethical Principles and Rules of Conduct* (CEPROC) is aligned with that of the IESBA, commensurate with its obligations as the founding member of the IFAC. We disapprove of the use of legal excuses above ethics, probity, propriety and best practice. However, we believe that the proposals in the ED are an aggressive consequence to the recent corporate scandals and we visualize the following quandaries:

- High possibility of legal liability for professional accountants;
- Risks to the professional accountants where the management and/or regulators could not be trusted or relied upon;
- Likelihood of behavioral issues such as withholding of information from the professional accountants and lack of trust in professional accountants;
- Loss of trusted advisor status as professional accountants are pitted against their clients; and,
- Competitive disadvantage relative to other professionals, such as lawyers, who are not burdened with similar obligations but, on the contrary, enjoy privileged communication with their clients. For example, an individual client will be more comfortable discussing tax matters with a professional tax lawyer relative to a professional tax accountant, if the proposals in the present ED become effective.

In order to highlight the last bullet point, we would also like to refer to a study¹ that explores the actions of both Arthur Andersen and Vinson & Elkins as they related to the Enron fraud. Analysis is given to the inherent differences between the roles of accountants and lawyers in business transactions and consideration is given to the specific actions of the lawyers and accountants involved with Enron, given their respective professional duties and obligations. The premise of this study is that Vinson & Elkins and Arthur Andersen each played equally essential roles in the perpetuation of the fraud, and that it was an inequitable result that Arthur Andersen met its demise while Vinson & Elkins survived relatively unscathed.

We note that the original goal of the project was to provide only **additional guidance** for professional accountants in public practice and in business on how to respond in situations where they encounter a suspected fraud or illegal act. However, the proposals in this ED are likely to impose onerous burden on professional accountants; expand the scope of obligations of the

¹ Smith, Eric Steven, “Meeting Their Professional Obligations? – A Comparison of the Professional Obligations of Enron’s Attorneys and Accountants” (October 1, 2010). *Ethics and Critical Thinking Journal*, Vol. 2010, No. 3, pp. 35-62, 2010.

professional accountants, and enhance the expectations of the public from the professional accountants. We also visualize significant implementation issues because of differing legal environments across jurisdictions - an unfair result for those jurisdictions where the requirements will not be implemented due to the legal environment, when compared to those jurisdictions where the provisions will have to be fully enacted. We note that the proposals in this ED will create significant difficulties for the SMPs and professional accountants in business without any legal or financial support from the relevant professional accounting body. We are also concerned that the proposals would undermine the trust of clients and employers in professional accountants. Furthermore, we must recognize that the proposed sections may add *significantly* to the obligations of professional accountants, both in respect of existing ethical requirements and law and regulations. These new obligations have a real cost to firms, one which is not likely to be funded by a client since the tangible work product (output) provided to them will remain unchanged.

We concur with dissenting views of one of the IESBA members² that does not support “the provisions that establish an *obligation* for a professional accountant to report a suspected illegal act by a client to a third party outside the client, regardless of the circumstances, as there are no means for the Code of Ethics to provide the protections that must necessarily accompany such a serious obligation. The legal and ethical implications of imposing such an obligation are so complex, the jurisdictional issues so diverse, and the personal impacts so potentially severe, that the regulation of whistleblowing should be the sole responsibility of those in each jurisdiction (e.g., legislators) who have the authority to accompany such a serious obligation with the appropriate protections.”

We believe that IESBA can further the goal of enhancing the credibility of the profession by conducting the post implementation review of the extant code and resolving issues arising from such review in order to make the code explicit and robust. An ardent and overzealous code of ethics which would enervate professional accountants instead of empowering them is not the right course of action. We invite the ISEBA to revise the proposals in the present ED so as to provide only additional guidance in the instances of suspected illegal acts, in accordance with the original intention of the project without imposing sweeping new requirements on the professional accountants.

Should you wish to discuss the contents of this comment paper or require further elaboration on any of the items presented herein, please do not hesitate to contact Kamalesh Gosalia at kgosalia@cga-canada.org or alternatively the undersigned at rlefevre@cga-canada.org

Sincerely,



Rock Lefebvre, MBA, CFE, FCIS, FCGA
Vice-President, Research & Standards

² Ms. Orbea, expressed these views at the IESBA meeting held in New York on June18-20, 2012.