



**The Japanese Institute of
Certified Public Accountants**

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December 21, 2012

Mr. Ken Siong
Acting Deputy Director
International Ethics Standards Board for Accountants
International Federation of Accountants
529 Fifth Avenue, 6th Floor,
New York, NY 10017
USA

Dear Mr. Siong:

Re: JICPA Comments on the IESBA exposure draft “*Responding a Suspected Illegal Act*”

The Japanese Institute of Certified Public Accountants (“we”, “our” and “JICPA”) is grateful for the opportunity to comment on the International Ethics Standards Board for Accountants (IESBA) Exposure Draft “*Responding to a Suspected Illegal Act*” (ED).

We understand that the ED attempts to address a difficult issue of responding to suspected illegal acts for professional accountants. However, when considering how to apply the proposed requirements in practice, there are a number of issues that are unclear and difficult to fully understand, and as such, some concerns or reservations have aroused over the proposed requirements. Specifically, we believe that it is important for the IESBA to reflect on the prevailing laws and regulations of some jurisdictions, before trying to introduce a requirement for professional accountants to disclose certain suspected illegal acts to an appropriate authority. We, therefore, generally do not agree with the requirements proposed in the ED and, believe that the proposed requirements should all be reconsidered.

Specific concerns or reservations that aroused during our discussion of the ED are set out below in our responses to the questions raised in *Request for Specific Comments* of the ED.

In addition to our specific comments to the questions raised in the ED, we would also like to suggest the IESBA to clarify what is meant by the “level of suspicion” with regard to suspected illegal acts. Depending on the interpretation of the level of suspicion, we believe that a professional accountant’s response to the requirement of disclosing suspected illegal acts would vary, and therefore, the IESBA needs to clarify its intended level of suspicion when referring to suspected illegal acts. In our understanding, the intended level of suspicion proposed in the ED is equivalent to that of a “suspected fraud” as set forth in ISA 240, thus, fairly high. If this is true, then the IESBA should clearly state that the level of suspicion mentioned in the ED should be understood to be equal to that specified in ISA 240. Our comments below have been made on the basis of this view.

Furthermore,, with regard to paragraph 225.5, which requires an accountant to take reasonable steps to confirm or dispel the suspicion, there are no specific references as to what has been envisaged by the term “reasonable steps.” Therefore, we believe that IESBA should identify or illustrate the kinds of steps that are expected to be taken by professional accountants.

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?

We agree with the proposal only when it is applied to a professional accountant in an audit engagement, but not in others.

Since management of an entity is responsible for appropriately addressing an illegal act within an entity, we are of the view that, when a professional accountant identifies a high probability of constituting a suspected illegal act, he or she should first discuss the matter with an appropriate level of management who would be expected to first address the matter in the entity. If no appropriate action is taken by those with whom the matter has been discussed, it would then be appropriate to escalate the matter to higher levels of management, to be consistent with corporate governance structures of the organization. ISA 250 also states that, when a professional accountant conducting an audit of financial statements identifies a suspected illegal act that has material effects on financial reporting, he or she is required to discuss the matter with management and, where appropriate, with those charged with governance.

A professional accountant who is not providing services as an auditor may lack close relationships with management or with those charged with governance of an entity. In such a case, a professional accountant would be responsible for communicating the matter only with an appropriate level of management who would be expected to first address the matter. Therefore, we believe that the IESBA should not require such a professional accountant who is not providing services as an auditor to escalate the matter and follow up with higher levels of management.

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?

We believe that a right to override confidentiality and disclose certain illegal acts to an appropriate authority should be considered in light of laws and regulations of each jurisdiction, and that each jurisdiction should determine whether such a right should be granted to a professional accountant. Additionally, if a right to disclose would be established by legislation, protection mechanisms for a professional accountant who make sure a disclosure would be necessary, otherwise, we believe that the right would not be effective.

Some jurisdictions, for example, already have laws or regulations that require auditors to disclose illegal acts that would have material effects on financial reporting to regulatory authorities. In general, such disclosure requirement is accompanied by regulations that afford protection to those who make disclosures, and therefore, a right to disclose would be effective.

Insofar as there are no laws or regulations that require such disclosures, and no protection is afforded by legislation, we are concerned that it would be very ineffective to require a professional accountant to disclose certain illegal acts, or to expect a professional accountant to exercise his or her right to disclose.

In view of the variety of regulations across jurisdictions, although the Code of Ethics is a global standard, in order for the proposed requirements of the ED to be prescribed and implemented, we believe that the IESBA should study the prevailing laws and regulations of each jurisdiction, and thus, should state that whether a professional accountant has a right to disclose should be determined by each jurisdiction.

Also, unlike a right to protect one's professional interests described in the Code of Ethics, the meaning of the term "right" in a proposed right to override confidentiality and to disclose is difficult to understand for non-native English speakers such as ourselves. Therefore, we suggest that the term "right" be clarified, in light of in what circumstances a professional accountant is expected to exercise this right.

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?

We do not agree with the proposal. Since the threshold for reporting to an appropriate authority, which described as suspected illegal acts that are of such consequence that reporting would be in the public interest, is not clear enough, it would be very difficult to determine when a matter is in the public interest, and as a result, could possibly cause an excessive burden on practice or an inconsistent conclusions among professional accountants. We are therefore concerned that such a threshold would be highly ineffective in the absence of explicit legal provisions with well-defined circumstances.

Also, we are not sure of a circumstance when the public interest threshold could justify disclosures overriding the confidentiality principle in services other than financial statements audit of listed companies. Therefore, we believe that the threshold, defined as “a suspected illegal act is of such a consequence that disclosure to an appropriate authority would be in the public interest,” is too abstract to be applied uniformly and appropriately to all services performed by professional accountants.

In addition to the threshold that a suspected illegal act is of such a consequence that disclosure would be in the public interest, we believe that there should also be a threshold established to reflect laws and regulations of relevant jurisdictions, and that each jurisdiction should be permitted to decide its own threshold for reporting.

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?

We agree with the proposal.

In consideration of the subject matter of services provided to a non-audit client, requiring a professional accountant in public practice providing services to a non-audit client to report suspected illegal acts similar to a professional accountant in public practice providing services to an audit client would be overly burdensome. As they may not have appropriate access to management or those charged with governance of an entity, it may be difficult for them to comply with such requirements in practical terms. For these reasons, we believe that it would be inappropriate to apply the same requirements.

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?

We agree with the proposal, provided that the reporting of suspected illegal acts that would have material effect on financial reporting has already been defined in laws and regulations of jurisdictions. When no such laws or regulations are in place, there may be situations where there is

no appropriate authority to receive disclosures even when a suspected illegal act which would have material effect on financial reporting is identified. Therefore, if reporting be required for auditors, we recommend for the IESBA to clarify actions to be taken in such circumstances.

In addition, when an auditor determines that a suspected act is highly likely to be illegal and discloses the matter to an appropriate authority, the auditor may be exposed to a risk of litigation by audit clients, if the investigation by the authority later turns out to be legal and when the disclosure causes disadvantage to them. We are concerned that auditors may be put under too much pressure when there is no legal basis for such disclosures. We therefore believe that each jurisdiction should be permitted to decide whether such disclosures should be required, in light of its prevailing laws and regulations.

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?

We do not agree with the proposal.

It would be difficult, in practice, to impose an obligation to a professional accountant who provides non-audit services to an audit client. We believe that the IESBA should also consider whether it would be possible for a professional accountant providing professional services to an audit client of a firm or a network firm to communicate and consult with an engagement partner of the audit of the same audit client.

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?

No, and we do not also agree with the proposal stated earlier in Question 5.

If laws or regulations are in place for the disclosure of suspected illegal acts, then, the scope of suspected illegal acts would be explicitly defined under such laws and regulations. If there exists no laws or regulations for such disclosures, we understand that the determination as to whether a given act falls into a suspected illegal act to be disclosed would be left principally to individual professional accountant's discretion, and it would not be necessary to involve a firm in its

determination. From this standpoint, we are of the view that the following concerns or reservations should be clarified:

- It would be necessary to clearly state that the expertise of a professional accountant should be attributed to the professional capability of an individual professional accountant.
- If the scope of the illegal acts were to include those that are within the expertise of persons other than professional accountants, such as legal counsels or IT professionals, then the scope of illegal acts to be disclosed would be too broad for a professional accountant in public practice to deal with, and therefore, would be difficult to handle the matter in practice. We are also concerned that the role of an accounting firm could be misunderstood by others, that a firm is also expected to disclose a wide range of illegal acts to authorities.

Given that different laws and regulations are in effect in various jurisdictions, it should be explicitly stated that each jurisdiction is to determine the scope of illegal acts to be disclosed.

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?

We do not agree with the proposal.

To override the fundamental principle of confidentiality and disclose suspected illegal acts to an external auditor, a professional accountant must obtain client's acknowledgement, when entering into an agreement for professional services, that such a case could nullify the confidentiality obligation.

However, there would be many cases where no such consent can be obtained from a client in practice. Hence, the effectiveness of the proposed requirement is questionable. We therefore believe that, for professional accountants providing professional services to non-audit clients, their responsibility could be sufficiently discharged not by requiring them to disclose a suspected illegal act to the entity's external auditor, but by requiring them to discuss the matter with an appropriate level of management who can be expected to first deal with a suspected illegal act, as their responsibility could only be extended to communicating the matter with an appropriate level of management.

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?

We do not agree with the proposal.

We have concerns described in our response to Question 8, and have reservations about the extent to which the “right to disclose” would actually be exercised. Also, as we believe that a professional accountant providing professional services to a non-audit client should only be responsible for discussing the matter with the appropriate level of management who can be expected to first respond to the matter, those professional accountants should not have a right to disclose, or not be expected to exercise that right.

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?

Although we do not agree with the disclosure as stated in our responses to Questions 8 and 9 above, if such disclosures were to be made, we believe that the suspected illegal acts to be disclosed should be those that are related to the subject matter of the professional services provided by professional accountants.

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?

We do not agree with the proposal.

Persons to be informed of a suspected illegal act should not necessarily be restricted to an external auditor. There may be situations, for example, where it may be appropriate to disclose a suspected illegal act to a legal counsel commissioned to oversee a whistle-blowing procedure of an entity. We therefore believe that the disclosure to an external auditor should not be required, and a professional

accountant should be provided a selection of persons, such as an external auditor or a legal counsel, to be consulted, and should decide, within his or her own discretion, to whom the matter is to be reported.

Furthermore, with regards to professional accountants in business, we believe that they should be expected to advise management of an employing organization to respond to the matter by using their governance mechanisms, such as whistle-blowing mechanisms, when they identify a suspected illegal act. Nevertheless, careful consideration would have to be given to various kinds of works assigned to professional accountants in business and diverse environments that they are situated in.

There may be environments where in some jurisdictions entities often employ several professional accountants, and some of them may hold a position of CFOs or persons charged with governance, whereas in some other entities or jurisdictions, there may only be a limited number of professional accountants in business. Therefore, prescribing a blanket requirement for all professional accountants in business would impose an excessive burden and create situations that would be difficult for them to deal with in practice.

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?

Please refer to our response to Question 2.

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?

We do not agree with the proposal.

Since it is assumed that professional accountants in business would perform various services compared to professional accountants in public practice, the two types of suspected illegal acts to be disclosed should not be addressed in parallel. Acts the subject matter of which falls within the expertise of professional accountants in business should mainly be required to be disclosed, and acts that affect the employing organization's financial reporting, on the other hand, should be limited to those that professional accountants become aware of during the course of their work.

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?

As commented above, we do not agree that a professional accountant should be required to disclose, or expected to exercise the right to disclose, certain illegal acts in the absence of legislation that regulates disclosure. If the disclosure is required by laws or regulations, the accountant should comply with such laws and regulations. If the IESBA were to require disclosure as stated in the ED, it would impose an enormous burden on professional accountants when they are required to disclose, or expected to exercise the right to disclose, even in exceptional circumstances where there are threats to their physical safety.

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?

As stated in our comments to Question 14 above, if the IESBA were to require disclosure, we 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.

Question 16. Do respondents agree with the documentation requirements? If not, why not and what documentation should be required?

We agree with the documentation requirements, as documentation is one of the most useful means for a professional accountant to prove how he or she responded to the identified 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?

We do not agree with the proposed changes. We expect to see changes that would resolve our above mentioned concerns or reservations. After such changes are made, the proposed changes to the existing sections of the Code should be incorporated.

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?

We do not agree with the analysis presented. We believe that there would be other impacts that are related to our concerns or reservations described above.

We hope that our views will be of assistance to the IESBA.

Sincerely yours,

Keita Yoshida
Executive Board Member - Ethics Standards
The Japanese Institute of Certified Public Accountants