

December 14, 2012

International Ethics Standards Board for Accountants
529 Fifth Avenue – Sixth Floor
New York, NY 10017

RE: Exposure Draft, *Responding to a Suspected Illegal Act*

Dear Board Members:

McGladrey LLP appreciates the opportunity to comment on the International Ethics Standards Board for Accountants' (IESBA) Exposure Draft, *Responding to a Suspected Illegal Act*. McGladrey is a registered public accounting firm in the United States focused on serving the middle market.

Among other matters, the IESBA Exposure Draft addresses circumstances where a professional accountant is required to override the fundamental principle of confidentiality and disclose a suspected illegal act to an appropriate authority. We believe it is in the public's interest for the professional accountant to report suspected illegal acts to the appropriate levels of management of a client, and to those charged with governance if management's response is not appropriate and timely. Per paragraph 225.13 of the Exposure Draft, however, if the entity has not made an adequate disclosure within a reasonable period of time, after being advised to do so, the professional accountant or the engagement partner for the audit would be *required* to disclose to the appropriate authority suspected illegal acts that directly or indirectly affect the client's financial reporting and suspected illegal acts the subject matter of which falls within the expertise of the professional accountant. For the reasons stated below, we do not agree that a professional accountant should be *required* to disclose suspected illegal acts to an appropriate authority in the manner dictated by the Exposure Draft.

General Comments

1. Conflict of Law

In the United States (US), there are state laws that recognize that a professional accountant has a general duty of confidentiality with respect to information provided by its clients and information gathered from its clients in the course of providing professional services. For example, most states have confidentiality statutes or regulations that prohibit CPAs from voluntarily disclosing client or employer records or information to third parties, including regulatory authorities, without client consent.

There are also US federal laws and regulations related to the duty of the professional accountant to keep client information confidential. For example, the United States Congress has passed legislation that imposes civil and criminal penalties on tax preparers who knowingly or recklessly disclose to third parties information furnished to them in connection with the preparation of tax returns. These penalties would only be waived in certain, very narrow, circumstances. For example, these narrow circumstances provide a right (not a requirement) for the professional accountant to disclose violations of criminal laws to government authorities, however the exceptions do not give the professional accountant the right to make any disclosure of suspected violations of other laws (i.e., civil or administrative laws) to government authorities or any other third party.

The proposed requirement to disclose suspected illegal acts to appropriate authorities and to external auditors would, in many instances, conflict with existing confidentiality requirements under U.S. federal and state laws. This conflict would place the professional accountant in the position of being forced to choose between violating the law or violating the Code of Conduct. Therefore, we believe it should not be IESBA, but rather the appropriate legislative bodies in each jurisdiction who should decide whether to impose a requirement on or grant a right to a professional accountant to make such disclosures.

2. Safe Harbor

We believe the proposed draft, if enacted, will result in a significant increase in lawsuits by audit clients against professional accountants and their firms. The proposed draft acknowledges the IESBA's inability to create a safe harbor for those accountants who report a suspected illegal act to the proper authority, akin to Section 10A(c) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j-1(c). See IESBA Explanatory Memorandum at 9. Yet it provides a standard of care requiring that "[w]hen making a disclosure to an appropriate authority, . . . the professional accountant shall act reasonably, in good faith and exercise caution when making statements and assertions." See IESBA Proposed Additions § 225.15. The natural result of this construct is that, nearly every time an accountant reports an illegal act to an authority as required under the proposed code, the audit client will assert a claim of bad faith in private litigation unless the applicable jurisdiction has its own safe harbor provision. Not only will this result in firms expending additional time, money and resources defending such lawsuits, but will likely have the unwanted consequence of some accountants waiting until they are absolutely certain that an illegal act has been committed before reporting it to the authorities. Therefore, we believe the decision to disclose a matter to an appropriate authority ordinarily should lie with management and those charged with governance, not the professional accountant. Additionally, as stated above, it should not be IESBA, but rather the appropriate legislative bodies in each jurisdiction who should decide whether to impose a requirement on or grant a right to a professional accountant to make such disclosures, accompanied by appropriate protective mechanism for the professional accountant.

3. Regulator Role

The quality of an audit is built on the integrity, competence, objectivity and independence of the professional accountant. A professional accountant providing audit services clearly must be without bias with respect to the audit client otherwise the auditor would lack the impartiality necessary for the dependability of the audit findings. Independence does not imply that the auditor would have the attitude of a prosecutor, but rather a judicial impartiality that recognizes an obligation for fairness not only to management and owners of a business but also to creditors and those who may otherwise rely (at least in part) upon the independent auditor's report, as in the case of prospective owners or creditors. Requiring the professional accountant to disclose suspected illegal acts to the appropriate authority would, in reality, put the professional accountant in a "regulator" role. Placing the professional accountant in a regulator role changes the impartial position of the auditor and may make the client more inclined to withhold information, or be less forthcoming. The withholding of information will have a detrimental impact of the ability of the auditor to gather sufficient appropriate evidence to support an opinion on the financial statements and will harm the quality of the services provided.

4. Confirming or Dispelling Suspicion

Per paragraph 225.5 of the Exposure Draft, if a professional accountant in public practice providing professional services to an audit client of the firm or network firm acquires, or receives, information that leads the accountant to suspect that an illegal act has been committed by the audit client, or by those charged with governance, management or employees of the audit client, the accountant must take reasonable steps to confirm or dispel that suspicion. In doing so, the professional accountant may not have access to all the information needed to be able to confirm or dispel the suspicion that an illegal act

was committed (either due to the withholding of information by the client or the professional accountants lack of legal expertise), and this may lead to an increase in disclosures of an erroneous nature.

5. Disclosure in the Public Interest

Paragraph 225.10 of the Exposure Draft states, “If the professional accountant or the engagement partner for the audit determines that the suspected illegal act is of such consequence that disclosure to an appropriate authority would be in the public interest, there is an appropriate authority to receive the disclosure, and the matter has not been disclosed, the accountant or the engagement partner for the audit shall advise the entity that the matter should be disclosed to the appropriate authority.” We believe that what is deemed to be in the public interest is a vague concept and will vary from person to person. Additionally, it is unclear how the determination that a matter is in the public interest should be made. The subjective judgment required to make this determination could result in a wide range of conclusions and produce inconsistent results.

Accountants are more familiar with the concept of materiality, so disclosing matters that have a material effect on the financial statements may be a more concrete threshold for disclosure than reporting a suspected illegal act if it is in the public interest. For example, the U.S. Securities and Exchange Commission only requires the auditor to report illegal acts under Section 10A of the Securities Exchange Act of 1934 if the illegal act has a material effect on the financial statements of the issuer.

6. Appropriate Authority

Paragraph 225.12 provides an imprecise definition for *appropriate authority*: “An appropriate authority is one with responsibility for such a matter.” Although it is clear that the appropriate authority to which to disclose the matter will depend on the nature of the suspected illegal act, it is not clear exactly which authority would be appropriate. A professional accountant providing professional services to an audit client may not have the requisite knowledge to determine who would be considered the appropriate authority for the disclosure of certain illegal acts.

7. Professional Accountants Providing Nonattest Services

Per the Exposure Draft, a professional accountant providing non-audit services to a client that is not an audit client and a professional accountant in business would be required to disclose suspected illegal acts to the entity’s external auditor. There are rules, regulations and laws in the United States that would make such disclosure illegal, see General Comment No. 1 above. However, if IESBA decides to move forward with this proposal it would be beneficial for the external auditor to be informed of such a suspected illegal act in a timely manner.

Responses to Request for Specific Comments

In response to the questions posed in the Exposure Draft’s request for specific comments, we are also providing some additional comments below. These comments should be read in light of, and are qualified by, our comments on the proposed standard set forth in the “General Comments” section.

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 it would be appropriate for a professional accountant to report suspected illegal acts to the appropriate levels of management of a client, and possibly with those charged with governance, if the

professional accountant is a member of management or if management's response is not timely and appropriate.

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?

No. For the reasons discussed in our General Comments above, we believe that the decision to disclose a suspected illegal act to an appropriate authority ordinarily should lie with management and those charged with governance, not the professional accountant. Additionally, it should not be IESBA, but rather the appropriate legislative bodies in each jurisdiction who should decide whether to impose a requirement on or grant a right to a professional accountant to make such disclosures, accompanied by appropriate protective mechanism for the professional accountant.

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?

No. For the reasons discussed in General Comments No. 5 above, we believe the "public interest" standard for disclosure in the Exposure Draft is vague, and would likely lead to inconsistent and subjective interpretations of the obligations that the IESBA proposes to place on professional accountants who become aware of a suspected illegal act. We believe professional accountants would be more familiar with the concept of materiality and therefore disclosing matters that have a material impact on the financial statements would be a more concrete threshold.

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 that it may be appropriate to establish a standard for a professional accountant in public practice providing services to an audit client that differs from the standard for a professional accountant in public practice providing services to a non-audit client.

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?

No. For the reasons discussed in our General Comments above, we believe the decision to disclose a suspected illegal act to an appropriate authority ordinarily should lie with management and those charged with governance, not the auditor. Additionally, it should not be IESBA, but rather the appropriate legislative bodies in each jurisdiction who should decide whether to impose a requirement on or grant a right to an auditor to make such disclosures, accompanied by appropriate protective mechanism for the auditor.

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 agree it would be appropriate for such individuals to report suspected illegal acts to the appropriate levels of management of a client, and possibly with those charged with governance, if management's response is not appropriate. However, we believe if the suspected illegal act relates to the client's

financial statements, the non-auditor should bring the matter to the attention of the audit engagement partner and the audit engagement partner should escalate the matter, if appropriate.

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?

For the reasons discussed in our General Comments above, we believe the decision to disclose a suspected illegal act to an appropriate authority ordinarily should lie with management and those charged with governance, not the professional accountant. Additionally, it should not be IESBA, but rather the appropriate legislative bodies in each jurisdiction who should decide whether to impose a requirement on or grant a right to a professional accountant to make such disclosures, accompanied by appropriate protective mechanism for the professional accountant. However, subject to our observations included in the General Comments above, we agree, if disclosures were to be made, it would be appropriate to disclose certain suspected illegal acts that affect the client's financial reporting, or that relate to subject matters that fall within the expertise of other professional accountants at the firm.

8. Do respondents agree that 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 would support a requirement that professional accountants in public practice providing services to a client that is not an audit client of the firm or a network firm and professional accountants in business be required to consider disclosing a suspected illegal act to the external auditor, provided that such disclosure would not violate any legal or contractual confidentiality or non-disclosure requirements applicable to the accountant's engagement or employment. We also believe that if disclosure is considered to be appropriate, the external auditor be informed in a timely manner.

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?

No. For the reasons discussed in our General Comments above, we believe the decision to disclose a suspected illegal act to an appropriate authority ordinarily should lie with management and those charged with governance, not the professional accountant. It should not be IESBA, but rather the appropriate legislative bodies in each jurisdiction who should decide whether to impose a requirement on or grant a right to a professional accountant to make such disclosures, accompanied by appropriate protective mechanism for the professional accountant. In addition, we do not believe that there is any actual difference between a professional accountant's requirement and "right" to disclose certain illegal acts to an appropriate authority as it has been drafted in the proposed standard, since the Exposure Draft states that the accountant "is expected to exercise that right in order to fulfill the accountant's responsibility to act in the public interest."

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?

For the reasons discussed in our General Comments above, we believe the decision to disclose a suspected illegal act to an appropriate authority ordinarily should lie with management and those charged with governance, not the professional accountant. Additionally, it should not be IESBA, but rather the appropriate legislative bodies in each jurisdiction who should decide whether to impose a requirement on or grant a right to a professional accountant to make such disclosures, accompanied by appropriate protective mechanism for the professional accountant. However, subject to our observations in the General Comments above, we agree, if disclosure were to be made, it would be appropriate to disclose certain suspected illegal acts that relate to subject matters that relate to the subject matter of the professional services being provided by the professional accountant.

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 would support a requirement that professional accountants in public practice providing services to a client that is not an audit client of the firm or a network firm and professional accountants in business be required to consider disclosing a suspected illegal act to the external auditor, provided that such disclosure would not violate any legal or contractual confidentiality or non-disclosure requirements applicable to the accountant's engagement or employment. We also believe that if disclosure is considered to be appropriate the external auditor be informed in a timely manner.

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?

No. For the reasons discussed in our General Comments above, we believe the decision to disclose a matter to an appropriate authority ordinarily should lie with management and those charged with governance, not the professional accountant. It should not be IESBA, but rather the appropriate legislative bodies in each jurisdiction who should decide whether to impose a requirement on or grant a right to a professional accountant to make such disclosures, accompanied by appropriate protective mechanism for the professional accountant. In addition, we do not believe that there is any actual difference between a professional accountant's requirement and "right" to disclose certain illegal acts to an appropriate authority as it has been drafted in the proposed standard, since the Exposure Draft states that the accountant "is expected to exercise that right in order to fulfill the accountant's responsibility to act in the public interest."

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?

For the reasons discussed in our General Comments above, we believe the decision to disclose a suspected illegal act to an appropriate authority ordinarily should lie with management and those charged with governance, not the professional accountant. Additionally, it should not be IESBA, but rather the appropriate legislative bodies in each jurisdiction who should decide whether to impose a requirement on or grant a right to a professional accountant to make such disclosures, accompanied by appropriate protective mechanism for the professional accountant. However, we believe it would be appropriate to require a professional accountant in business to encourage an employer to disclose to an appropriate authority certain suspected illegal acts that affect the employing organization's financial reporting, or that relate to subject matters that fall within the expertise of the professional accountant.

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?

For the reasons discussed in our General Comments above, we believe the decision to disclose a suspected illegal act to an appropriate authority ordinarily should lie with management and those charged with governance, not the professional accountant. Additionally, it should not be IESBA, but rather the appropriate legislative bodies in each jurisdiction who should decide whether to impose a requirement on or grant a right to a professional accountant to make such disclosures, accompanied by appropriate protective mechanism for the professional accountant. However, as indicated in our General Comments above, we believe it would be appropriate to require a professional accountant to consider encouraging a client to disclose to an appropriate authority certain suspected illegal acts that relate to subject matters that fall within the expertise of the professional accountant. As part of that consideration, we believe that it would be reasonable for a professional accountant to take into account exceptional circumstances that weigh against making such a recommendation.

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 be the exceptional circumstances be described?

Please see our response to Question 14 above.

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

No. While professional auditing standards require the documentation of certain issues addressed in connection with an audit engagement, the Code does not currently impose similar documentation requirements with the exception of documenting certain threats to independence and the safeguards applied, when safeguards are required, to reduce threats to an acceptable level. We believe that, if the IESBA moves forward with the proposal, the standard should instead call upon a professional accountant to consider documenting such factors as his or her understanding of the suspected illegal act, the inquiries made by the accountant, and management's response.

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?

No. We believe that any changes to the existing sections of the Code discussed in the Exposure Draft should be consistent with our General Comments. In particular, we do not believe that Section 140.7 of the Code should be amended to require professional accountants to comply with the requirements of proposed Sections 225 and 360, as currently drafted.

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 appreciate that the IESBA conducted an impact analysis and included the analysis in the Exposure Draft. We generally agree with the analysis as presented, however there are aspects of the analysis that we do not believe have been appropriately addressed in the Exposure Draft.

The impact analysis identifies as "high" and "ongoing" the increased exposure of professional accountants to litigation, if they disclose suspected illegal acts to appropriate authorities and their suspicions turn out to be unfounded. Similarly, the analysis identifies the potential exposure of

professional accountants to retaliation for making such disclosures as “high” and “ongoing,” since not all jurisdictions currently provide protective mechanisms to the accountants. These risks do not appear to be reflected, however, in the IESBA Exposure Draft. We believe they underscore why legislative bodies in each jurisdiction, which unlike the IESBA have the ability to provide protective mechanisms for professional accountants, should determine whether to impose a requirement on, or grant a right to a professional accountant to disclose suspected illegal acts involving clients or employers to external authorities. We refer you to our General Comment No. 1.

In addition, the impact analysis states that, if the proposals were adopted, professional accountants in public practice who are not auditors and professional accountants in business would now “have a process for confirming or dispelling suspicion of illegal acts.” The proposals would require such professional accountants to “take reasonable steps” to confirm or dispel their suspicions, and identifies their obligations if they were unable to do so. However, they do not identify what steps or procedures would be considered “reasonable” to confirm or dispel an accountant’s suspicions, other than to state that the accountant may wish to consult with others within their firm or, on an anonymous basis, with a relevant professional body. Accordingly, the proposed standard does not appear to provide professional accountants in public practice who are not auditors or professional accountants in business with a specific “process” for confirming or dispelling their suspicions in situations involving suspected illegal acts. In practice, we believe some firms might be required to devote significant time and expense to developing new policies and procedures for satisfying their responsibilities under the proposed standards. These costs are not reflected in the impact analysis.

The impact analysis also suggests that the proposals, if adopted, could lead to a possible reduction in the number of illegal acts because of the deterrent effect associated with a client’s or employer’s knowledge that a professional accountant would be required to disclose a suspected illegal act, or expected to exercise his or her right to disclose a suspected illegal act, to an appropriate authority. While the proposals, if adopted, might have some deterrent effect, we believe the impact analysis should also acknowledge that the existence of such disclosure obligations might also have a detrimental impact on the communications between professional accountants and their clients or employers. This could negatively impact the quality of the services provided by professional accountants, which would have a pervasive adverse impact on all stakeholders.

We would be pleased to respond to any questions the Board or its staff may have about these comments. Please direct any questions to Bruce Jorth (561.682.1623) or Shelly Van Dyne (612.455.9935).

Sincerely,

A handwritten signature in black ink that reads "McGladrey LLP". The signature is written in a cursive, flowing style.

McGladrey LLP