



RESPONDING TO SUSPECTED ILLEGAL ACTS

Comments from ACCA
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GENERAL COMMENTS

ACCA welcomes the opportunity to comment on the exposure draft setting out proposed changes to the Code of Ethics for Professional Accountants ('the Code'). The proposed changes are intended to set out appropriate responses of professional accountants to the discovery of suspected illegal acts, and we recognise and support the public interest in professional accountants responding appropriately.

However, while supporting the underlying sentiment, we do not support the specific proposals. We recognise that a professional accountant must respond to widely-held expectations to 'blow the whistle' on clear violations of the law, but that such a response must be within the applicable legal framework. There are, of course, jurisdictions in which the proposed changes to the Code would appear to conflict with local legislation and, in such cases, the Code states that the law will prevail (paragraphs 100.1 and 470.7(c)). The drafting of the provisions might nevertheless lead to confusion in jurisdictions in which the law prohibits breaches of confidentiality, and confusion due to the different expectations upon professional accountants working in different jurisdictions.

In jurisdictions in which professional accountants might be expected to breach confidentiality, because there is no legal prohibition, the accountant may be vulnerable to civil action when meeting expectations placed upon them as set out in the proposals.

The most balanced and effective means of achieving the appropriate ethical behaviour of professional accountants is by way of detailed guidance outside of the Code. We suggest that sufficient detail and explanation may not be provided within the conciseness that a code requires. Throughout the exposure draft, the following issues arise repeatedly:

- Prior to a trial taking place, the professional accountant can never be sure that an illegal act has been committed. Therefore, acts can only be regarded from the level of suspicion throughout the Code.
- Legislation in some jurisdictions will prohibit the reporting of suspected illegal acts; in others, there will be no such prohibition, and so there will be different expectations upon professional accountants, who will be

expected to report if, in their opinion, the public interest requires it. The Code cannot provide any protection for such professional accountants against a potential threat of litigation.

- The proposed additions to the Code provide no guidance concerning the relative significance of the suspicion or the act. This is of particular concern in jurisdictions in which the professional accountant would be exposed to liability.
- In jurisdictions in which legislation requires the reporting of certain suspicious activities to appropriate authorities, there are likely to be restrictions on ‘tipping off’ those responsible (eg EU anti-money laundering legislation). The internal reporting structure proposed in the exposure draft may, on occasions, appear to breach the ‘tipping off’ prohibition. Although (as noted already) the Code states that, in such circumstances, the law shall prevail, we are concerned that there is scope for confusion such that instances of ‘tipping off’ may occur more frequently.
- Although professional accountants and professional bodies must strive to act in the public interest, the understanding of public interest will differ between individuals but, more significantly, between different cultures.
- Matters to be disclosed are not clearly set out within the exposure draft, and clearly they are to be based on personal judgement. In addition, in many jurisdictions, the appropriate authority to which disclosure should be made is not clearly identifiable.

A further advantage of containing external reporting requirements within legislation is that it may then apply to a range of professionals, and not simply professional accountants who are bound by the Code. Apart from creating a ‘level playing field’ for professionals, this would remove the ability of wrongdoers to conceal their illegal acts by engaging alternative (perhaps unregulated) professionals. This is surely in the public interest.

SPECIFIC QUESTIONS

- 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?**

In principle, we agree that discussion of a suspicion at an appropriate level would usually be in the public interest, provided the suspected illegal act was of a certain significance, and the professional accountant was protected from any accusation of 'tipping off'. However, we have concerns regarding the requirement that a professional accountant should take 'reasonable steps' to confirm or dispel a suspicion, as there is no guidance regarding what is 'reasonable', and we believe that this should be related to the materiality (or significance) of the act concerned.

Any attempt to address issues of the significance of suspected illegal acts, or whether any form of disclosure is in the public interest, will be problematic in a global context. Although IESBA and ACCA would agree that there should be a universally acceptable ethical standard for all professional accountants, the proposed amendments to the Code would require professional accountants to consider the suspected illegal acts of *others*, and so, between different jurisdictions, suspected transgressors will be subject to a variety of both economic and cultural values.

We acknowledge that the proposed paragraph 225.2 refers the professional accountant to 'any applicable legal or regulatory requirements governing how the suspected illegal act is to be addressed'. Where such legal requirements do not exist, the professional accountant would not be adequately protected if reporting his suspicions outside the company. However, where such legal requirements *do* exist, the proposed additions to the Code add little except for scope for confusion.

We support the requirements of International Standard on Auditing (ISA) 250 – that an auditor's appropriate response to a suspected breach of the law includes reporting to those charged with governance, reporting by way of the audit

report, and reporting to 'regulatory and enforcement authorities', according to the auditor's legal responsibilities in the jurisdiction concerned.

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 [suspected] illegal acts to an appropriate authority?

In principle, we agree that a professional accountant should have the right to override confidentiality if to do so would be in the public interest. However, this should only be encouraged where safeguards exist to protect the professional accountant from liability should it transpire that his or her suspicions were mistaken. The Code cannot provide adequate safeguards in this respect.

Even in jurisdictions where appropriate legal safeguards do exist, the professional accountant would be well advised to seek legal advice before deciding to override confidentiality. With this in mind, and in view of the fact that paragraph 100.1 acknowledges that a professional accountant may be prohibited by law from complying with certain parts of the Code, it would seem entirely inappropriate to effect the proposed deletion from paragraph 100.21, which recommends obtaining legal advice.

In addition, any right to override confidentiality would need to be carefully defined. The exercise of a right to disclose a suspected illegal act is likely to be harmful to the professional accountant's relationship with the client, but also harmful to the profession. Upholding the fundamental principle of confidentiality is, itself, in the public interest, and any modification of the principle should be undertaken with extreme caution. It is important that any right to override confidentiality should not be characterised as giving accountants discretion to inflict reputational damage and administrative burdens on clients.

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 are not aware of an alternative criterion to public interest (except for legal compulsion), although we have already expressed our concerns regarding defining the public interest and reaching a global understanding of what public interest entails. Ultimately, this must be a matter of personal judgement, with the result that a wide variation in standard of 'public interest reporting' emerges, with the potential for confusion and abuse of the provisions of the Code.

'Public interest' itself could be susceptible to a range of interpretations, including those that might seek to justify non-disclosure. For example, in the case of a company with significant public sector contracts (and employment relying upon them), which is suspected of committing an illegal act, it might be claimed that disclosure is not in the public interest if prosecution could result in the company losing its ability to tender for public works contracts, with the resultant loss of many employees' jobs. This scenario demonstrates that public interest considerations are crucial but certainly not straight-forward, and they require a detailed analysis of the interests of the various stakeholders, as well as the wider public.

Matters specific to professional accountants in public practice

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?

The professional accountant should always be mindful of his or her public interest responsibility, and must take appropriate action when in the public interest, subject to the professional accountant being protected by law in his or her particular jurisdiction.

However, the requirements of auditors are stringent and clearly defined. (See our previous comments in respect of ISA 250.) Services provided to a non-audit client arise from a contractual arrangement and a different relationship between the client and the professional accountant, which relies, to a great extent, on safeguarding confidentiality. Different 'public interest' considerations apply. We would reiterate our support for the approach for auditors set out in ISA 250 and, particularly, the guidance provided in that standard.

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?

The auditor has a mechanism to report under ISA 250, and we would refer you to our answer to question 1. More generally, if the professional accountant has suggested that the client make a disclosure, for example to a regulator, and the client has not, then we must return to considering the need to disclose the matter in the public interest. Although failure of the client to make the disclosure might have an impact on the professional accountant's assessment of the public interest, there can be no 'bright line' rule about overriding confidentiality based purely on whether or not the entity itself has made certain disclosures.

We have grave concerns over the introduction of a requirement – particularly in a global context – but would welcome guidance concerning overriding confidentiality in the public interest, and seeking legal advice concerning the legal protection that might exist in a particular jurisdiction.

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?

Yes, we agree that the obligations should be the same. We have stated our support of the reporting provisions and guidance within ISA 250, and it would not be logical for a professional accountant within the same firm to avoid the obligations of the auditor. Professional accountants within audit firms who

suspect non-compliance with the law may be expected to communicate with the audit team in order to determine how the suspected illegal act might impact the audit. Therefore, the auditor is expected to be aware of the suspicion.

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?

This question should focus only on matters in relation to which there should be an ethical requirement placed on professional accountants. Their areas of expertise are only relevant with regard to their competence in evaluating the significance of their suspicions and, therefore, only indirectly in assessing the need to report their suspicions – either internally or externally. It would appear a reasonable assumption that a professional accountant preparing a tax computation for a client, and who suspects tax fraud, may be subject to different expectations concerning reporting to a taxation authority than an auditor who has similar suspicions. However, we would refer you to our answer to question 5, which expresses our concern regarding any regulatory requirement to override confidentiality.

It is important that professional accountants are clear about their responsibilities, including how to comply with the fundamental principles of confidentiality and integrity. They require guidance that explains how to report internally, and the criteria for reporting externally (ie in cases where the public interest in reporting externally exceeds the public interest in maintaining confidentiality).

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?

There appears to be an assumption that the auditor can escalate matters further than another professional accountant. If so, then the professional accountant reaches the point at which external reporting, in the public interest, must be

considered at an earlier stage. The option of reporting to the external accountant should be considered, but we are not in favour of this being a requirement. Requiring auditors to investigate another party's suspicion (which may not be related to the audit of the financial statements) is unjust and untenable. A requirement to report to the external auditor also opens up an inconsistency: where there is no external auditor, the professional accountant is 'expected to exercise' a right to report externally; however, if there *is* an external auditor (who considers it a public interest matter), external reporting becomes a requirement.

The only relevant question is whether it is in the public interest that the external auditor is alerted (because it would enhance the quality of the audit). We propose that, if a professional accountant determines that it is in the public interest to report the matter to an appropriate authority, the professional accountant should also report to the external auditor. Given that the professional accountant has already disclosed the matter to the appropriate authority, the responsibility of the external auditor (once satisfied that the public interest has been served by the disclosure already made) would be within the scope of ISA 250. It would be unjust and untenable for the auditor to be burdened with responsibilities beyond those supported by existing law and regulation.

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 [suspected] illegal acts to an appropriate authority and be expected to exercise this right? If not, why not and what action should be taken?

We support the right to override confidentiality, but based on clear guidance concerning public interest considerations. Having a *right* to exercise is different to being *expected* to exercise that right. A decision to disclose certain suspected illegal acts to an appropriate authority would be made on the balance of judgement, and it would seem inappropriate to have that judgement tainted by the fear that the professional accountant might not be complying with a requirement of the Code.

In many situations, the professional accountant would be exposed to liability if they disclose in the public interest when they should not have done so; but also if they do not disclose in circumstances in which they should have been 'expected' to do so.

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?

As with question 7, this question should only be concerned with which suspected illegal acts the professional accountant should be 'expected' to disclose. It is not necessary to relate those acts to the subject matter of the professional services being provided. We would refer you to our answers to questions 7 and 9 above.

There is also a danger that restricting the professional accountant's rights and responsibilities to report to the subject matter area in this way might be criticised if it is seen by the public as accountants trying to divest themselves of their reasonable responsibilities. It might also risk professional accountants losing sight of their responsibilities to safeguard fundamental ethical principles according to the conceptual framework.

Matters specific to professional accountants in business

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?

This is similar to the position underlying question 8 above although, in this case, it is a professional accountant in business who is unable to escalate the matter. Our answer to question 8 is entirely relevant in this context also.

It is important that a professional accountant, whether in public practice or in business, takes ethical responsibility, and is equipped to judge whether or not any disclosure is in the public interest. If he or she determines that there is a sufficiently serious public interest matter, external reporting (accompanied by a report to the external auditor) should be encouraged, but always subject to taking legal advice.

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

This is a very similar situation to that of an accountant in a professional firm and our response to question 9 above is relevant here also. We support the right to disclose in the public interest, but this should be encouraged by suitable guidance, and not incorporated within the Code. To attempt to do so could have the unintended consequence of eroding trust in the accountancy profession, because judgement concerning whether or not to maintain confidentiality may be tainted by the fear that the professional accountant might not be complying with a requirement of the Code.

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?

As stated in response to previous questions, when considering which suspected illegal acts should be disclosed, it is not always necessary to relate those acts to the subject matter of the professional accountant's expertise. Any restriction in the subject matter could be seen by the public as a means by which professional accountants may avoid their responsibilities. We believe that this restriction is artificial, although we acknowledge that a professional accountant would be well-advised to consider whether he or she has the expertise to identify a suspicion of illegality in areas with which they are relatively inexperienced.

Other

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

As we have attempted to make clear throughout this response, we do not support the proposal that a professional accountant should be required (or expected) to disclose any suspected illegal acts to an appropriate authority, except where prescribed by legislation, in which case we would expect that legislation to include provisions to protect the professional accountant as appropriate. Therefore, we cannot comment on what exceptional circumstances would relieve a professional accountant of such a requirement (or expectation).

15. If respondents agree that in exceptional circumstances a professional accountant should not be required, or expected to exercise the right, to disclose certain [suspected] 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?

Please refer to our answer to question 14 above. In general, disclosure must be considered on the basis of the public interest in disclosure of the suspected illegal act, compared with the public interest in upholding the principle of confidentiality. There might be value in guidance explaining also how the public interest of disclosure may be weighed against the personal interest of the professional accountant in, for example, his own safety.

An alternative approach might be to provide guidance that explains how the professional accountant may make a public interest disclosure to an appropriate authority, but explaining that an authority may not be 'appropriate' if, in the circumstances, the professional accountant has reason to believe that the fact of the disclosure will not be kept confidential by that authority. However, it might also be argued that the Code does not require provision in respect of exceptional circumstances, because if circumstances are truly exceptional, the professional accountant will make a personal judgement to breach the letter of the Code for the greater good. In fact, providing for exceptional circumstances

within the Code does nothing to promote better judgement by the professional accountant, but is likely to legitimise non-disclosure on the basis of 'exceptional circumstances'.

Proposed paragraph 225.14 concludes by saying that the professional accountant determines not only whether to terminate the professional relationship with the client but also whether it is appropriate to continue to provide professional services in the particular jurisdiction. Such action, if explained to clients in these terms, could be construed as insulting to clients in that jurisdiction.

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

The pertinent question here is whether the proposed documentation requirements would increase the quality of the ethical decision-making, and hence the impact of the decision-making in the public interest. In view of our overriding concerns regarding the reporting proposals, we are reluctant to comment on the documentation proposals. However, we would support appropriate guidance concerning the benefits of documentation for the professional accountant.

The proposals seem to rule out using materiality while acknowledging that auditing standards use materiality when discussing documentation for audit purposes of suspected illegal acts for example. However, the proposed wording states that the level of documentation will be commensurate with the gravity of the suspected illegal act. This seems very similar to materiality (in its widest sense, rather than in the context of financial reporting or auditing). We believe that the proposals carry inconsistencies, and this jeopardises clarity.

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 to the existing sections of the Code, largely due to reasons already explained throughout this response.

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?

In view of our overriding concerns regarding the reporting proposals, we are reluctant to comment in detail on the impact analysis. However, we note that the analysis focuses on the professional accountant in isolation. For many clients, the option is available to engage the services of unregulated service providers for services that might otherwise be purchased from a regulated professional accountant. There is a risk that the proposed regulation would act as an incentive for a client to disengage a regulated professional accountant, in favour of the unregulated provider.

For larger clients, the choice, in some cases, may be between going to an accountant for advice on a particular issue, or going to a lawyer or other expert. Any perception (however misguided) that the use of an accountant, rather than a lawyer for example, may result in an increased risk of regulatory intervention will place the accountant at a disadvantage in tendering for the services. While it may very well be that, in practice, lawyers are under equivalent obligations to serve the public interest, there is nevertheless a perception in many cases that lawyers do offer a 'more discreet' service (eg the ongoing debates and litigation in the UK concerning legal professional privilege).

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