

December 17, 2012

Mr. Ken Siong
Deputy Director
International Ethics Standards Board for Accountants (IESBA)
529 Fifth Avenue - 6th Floor
New York NY 10017

Email: kensiong@ifac.org

Re: IESBA Exposure Draft – “Responding to a Suspected Illegal Act”

Dear Mr. Siong:

PKF International Limited administers the PKF network of legally independent member firms. There are approximately 300 member firms and correspondents in 440 locations in roughly 125 countries providing accounting and business advisory services. PKF International member firms have \$2.6 billion aggregate fee income (year end June 2011) and the network is a member of the Forum of Firms – an organisation dedicated to consistent and high quality standards of financial reporting and auditing practices worldwide. This letter represents the observations of PKF International Limited, but not necessarily the views of any specific Member Firm or individual.

We welcome the opportunity to comment on the IESBA Exposure Draft “Responding to a Suspected Illegal Act” (“the ED”).

We are supportive of the IESBA’s continued efforts to develop and improve its Code of Ethics for Professional Accountants (“the Code”). We do not, however, fully support the proposals set out in the ED as explained below and in the responses to the specific questions posed in the ED.

We agree that a professional accountant should have a *right* to override confidentiality in order to report suspicion of illegal acts, either to an appropriate level of management and/or those charged with governance within an organisation or to an appropriate external authority, in the public interest. This should be subject to such reporting not resulting in a breach of local law, and there being statutory protection for the accountant from the consequences of such reporting in the particular jurisdiction, as well as overriding relief in the event of significant personal risk to the accountant. It is not, however, appropriate to impose a *requirement* or an *expectation* on a professional accountant to do so in a code of ethics intended for use in many jurisdictions. Whistle-blowing may result in severe consequences for the whistle-blower. Accordingly, such requirements should be determined by law.

Jurisdictional prohibitions may result in inconsistent application, which provides challenges to professional accountants in cross-border situations and specifically in group audits. This is not addressed in the ED.

Should some of the proposals be adopted, more guidance is required in a number of areas. The scope of the current proposals is too broad. For example, more guidance is required to assist professional accountants to determine what is “in the public interest”, as the term is likely to be interpreted differently in different jurisdictions.

No distinction should be made between the responsibilities of professional accountants acting in the capacity of auditor and those that are not, nor on the basis of whether or not the entity is subject to external audit. All professional accountants should be subject to the same rules and requirements and should have the right to override confidentiality in situations where it is appropriate to do so.

We do not consider it necessary to limit the right to areas where the accountant may be expected to have particular knowledge or expertise. The accountant should only be expected to report illegal acts that come to his attention in the course of his professional work and such matters should specifically exclude minor misdemeanours and acts of personal misconduct, except where reporting of these matters would be in the public interest.

An accountant, having thus reported a suspicion of an illegal act subject to local jurisdictional requirements, should have no further responsibility to pursue the matter or establish the outcome, unless required to do so by their specific engagement terms. The role of the accountant here should be one of 'whistle-blower', not one of detective, investigator or prosecutor.

We do not consider it appropriate to require professional accountants to report suspicions of illegal acts to external auditors, where the entity is subject to external audit, and auditors should not be required to act on any such reports. This requirement could put the external auditor in a management role that may compromise the auditor's independence.

Our responses to the questions raised in the 'Request for specific comments' section of the document follow.

Request for specific comments

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?*

No. A professional accountant should have the right to discuss matters with management or to report to an appropriate authority as they see fit, but not a requirement to do so.

Many jurisdictions have laws that prescribe the action to be taken when a professional accountant identifies a suspected illegal act. This is often contained in anti-money laundering laws or may be required under financial services, pensions, charities, anti-bribery and other legislation. Discussions with management may result in a breach of "tipping-off" provisions in such laws, and therefore may constitute an offence.

Proposed paragraph 225.3 of the Code acknowledges this fact and notes the position in relation to tipping-off, and notes that a professional accountant should comply with the anti-money laundering laws and comply with any prohibitions on tipping-off. Proposed paragraph 225.8 of the Code notes a mechanism by which the professional accountant should avoid tipping-off but still requires the professional accountant to pursue the matter. It is not clear why the Code should require professional accountants to go beyond what is required by local law. Where a report or disclosure has been made under local law, the requirements of the Code should fall away. Any prescriptive requirement for discussions with management, despite making allowances in the Code, increases the risk of tipping-off.

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?*

Yes. A right to override confidentiality and disclose certain illegal acts to an appropriate authority (subject to local law) is more appropriate than a requirement to do so, as this leaves the decision to

the professional judgment of the professional accountant, taking into consideration all relevant matters, and avoids the situations set out in our response to question (1).

Once the accountant has reported a suspicion of an illegal act to an appropriate external authority, we consider that the accountant should have no further responsibility to pursue the matter or establish the outcome. The role of the accountant should be one of 'whistle-blower' only.

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?*

Yes. This should, however, be subject to additional jurisdictional reporting requirements which may have different thresholds.

In addition, the interpretation of the term "in the public interest" may vary in different jurisdictions. The ED includes a "reasonable and informed third party test" which is important, but professional accountants in different jurisdictions (e.g. one in a highly litigious environment as opposed to not) may come to very different conclusions using this test. We note that IFAC has done some work in relation to a definition of the public interest (IFAC Policy Position 5, June 2012, 'A definition of the public interest' together with its 'At a glance' summary and appendices) but we note that the exposure draft does not refer to this work, which we would have expected.

As a minimum, there needs to be some flexibility and additional guidance in the Code in determining what is "in the public interest" and this should be a matter of professional judgment for the accountant.

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

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?*

No. The fact that the professional accountant may be providing services to an audit client or a non-audit client is not relevant. It is the professional accountant's response to encountering the suspected illegal act that is important, not whether the entity is subject to an audit requirement or not. It is the fact that the professional accountant is in public practice that is relevant.

The ED comments that "it is appropriate for an auditor to be required to disclose certain suspected illegal acts because of the auditor's role in safeguarding the public interest" but the very first sentence of Part A of the Code makes it clear that it is all professional accountants that should act in the public interest: paragraph 100.1 "A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest." It is therefore unclear why the IESBA considers it appropriate to include this distinction in the ED.

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. This should be a right, not a requirement, and the right should be subject to legal protection in the particular jurisdiction. We further do not agree with the distinction of auditors and others. Under the proposals, the auditor would be required to check whether the entity had made adequate disclosure within a reasonable period of time (after the necessary reporting and escalation internally). We do not consider this to be appropriate as this puts the auditor in the chain of command of the entity, which impacts on the objectivity of the auditor and is contrary to one of the fundamental principles of the Code. As above, any professional accountant should have the right to report to management, those charged with governance or an appropriate authority as they see fit.

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?*

No distinction should be made between the responsibilities of professional accountants acting in the capacity of auditor and those that are not, nor on the basis of whether or not the entity is subject to external audit. All professional accountants should be subject to the same rules and requirements and should have the right to override confidentiality in situations where it is appropriate to do so.

Accordingly we do not agree with certain requirements that relate to the auditor, e.g. the requirement in paragraph 225.18 to disclose the suspected illegal act under those circumstances to the entity's external auditor (see our response to question 8), nor do we 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 (see our response to question 4).

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. Limiting this right to acts that affect the client's financial reporting and acts that fall within the expertise of the professional accountant has no justification. The right should extend to all such acts, the disclosure of which would be in the public interest. Further, the accountant should only be expected to report illegal acts that come to his or her attention in the course of his or her professional work and such matters should specifically exclude minor misdemeanours and acts of personal misconduct, except where reporting of these matters would be in the public interest. Also note our previously expressed concerns about the determination of what is in the public interest.

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?*

No. The professional accountant should deal with the suspected illegal act as he or she would deal with it as if there was no external auditor in office. This avoids putting a client that has an audit at a disadvantage to a client that does not have an audit and also avoids placing a requirement on the auditor to act on "second hand" information.

Also, as set out in our response to question (4), we do not agree with the distinction between auditors and other professional accountants.

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?*

Yes, we agree with the right to override confidentiality as stated, provided it does not result in a breach of local law. This allows the professional accountant in public practice to use his or her professional judgment, taking into consideration all relevant matters.

We do not agree with the additional expectation that the right should be exercised. Proposed paragraph 225.18 (and 225.19 where the client is an individual) states that the professional accountant is "expected to exercise this right" in order to fulfil their responsibility to act in the public interest. This is putting a condition on the right to override confidentiality which will be difficult for professional accountants in public practice to interpret in practice. The additional condition amounts

to an obligation and is, therefore, more in the nature of a requirement, which we do not support. We suggest that this additional wording be modified or removed to eliminate any ambiguity and to assist with the practical interpretation of the paragraph.

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?*

No. Limiting this right to acts that affect the client's financial reporting and acts that fall within the expertise of the professional accountant has no justification. The right should extend to all such acts, the disclosure of which would be in the public interest. Further, the accountant should only be expected to report illegal acts that come to his or her attention in the course of his or her professional work and such matters should specifically exclude minor misdemeanours and acts of personal misconduct, except where reporting of these matters would be in the public interest. Also, note our previously expressed concerns about the determination of what is in the public interest.

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

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?*

No, particularly if the sole purpose is for the professional accountant to discharge their own professional responsibility. As noted earlier, we would prefer that the accountant reports any suspicions to the appropriate authority directly. This is for the same reasons as we set out in our response to question 8.

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?*

We agree that a professional accountant in business should have a right to override confidentiality and disclose certain illegal acts to an appropriate authority, as long as this does not result in a breach of local law. This allows the professional accountant in business to use his or her professional judgment, taking into consideration all relevant matters.

We do not agree with the additional expectation that the right should be exercised. Proposed paragraph 360.9 states that the professional accountant is "expected to exercise this right" in order to fulfil his or her responsibility to act in the public interest. This is putting a condition on the right to override confidentiality which will be difficult for professional accountants in business to interpret in practice. The additional condition amounts to an obligation and is, therefore, more in the nature of a requirement, which we do not support. We suggest that this additional wording be modified or removed to eliminate any ambiguity and to assist with the practical interpretation of the paragraph.

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?*

No. Limiting this right to acts that affect the employing organisation's financial reporting and acts that fall within the expertise of the professional accountant has no justification. The right should extend to all such acts, the disclosure of which would be in the public interest. Further, the accountant should only be expected to report illegal acts that come to his or her attention in the course of his or her professional work and such matters should specifically exclude minor misdemeanours and acts of personal misconduct, except where reporting of these matters would be in the public interest. Also, note our previously expressed concerns about the determination of what is in the public interest.

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 illegal acts to an appropriate authority? If not, why not and what action should be taken?*

Yes. The Code should apply under normal circumstances and when exceptional circumstances are encountered it is reasonable for the requirement to be modified.

We appreciate that where exceptional circumstances exist, it is likely that they relate to a matter that may be in the public interest to disclose, but the Code itself cannot offer any protection and in the absence of any protection available by local laws, the professional accountant should not be placed in such jeopardy.

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?*

Should some of the proposals be adopted, we agree that the exceptional circumstances described in the ED should be “so severe as to justify not exercising the right to disclose” but we do not agree with the subsequent example of “threats to the physical safety of the professional accountant or other individuals”. The thresholds need to be very clearly described. While we are supportive of an approach that encourages the exercise of judgement and principles, more examples are needed to illustrate practical application. There is an overall risk that different firms and accountants will interpret “exceptional circumstances” differently, or may well be subject to different jurisdictional requirements, resulting in an unlevel playing field (e.g. the risk of losing work or getting a reputation as a whistle-blower and the resulting damage to their business may cause accountants not to report), while others may take a more narrow view.

Specifically, it is unreasonable to restrict the threat to just a physical threat to include physical and non-physical threats and include family members and associates.

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

No. Proposed paragraphs 225.23 and 360.15 require documentation of all responses to suspected illegal acts, which is not in accordance with the comments on ‘Documentation’ in the explanatory memorandum. The explanatory memorandum comments that “the level of documentation would be commensurate with the gravity of the suspected illegal act” but this is not repeated in proposed paragraphs 225.23 and 360.15. We agree with the explanatory memorandum in that the documentation required should be commensurate with (or appropriate to) the gravity of the suspected illegal act. This would avoid documentation of every suspected illegal act, especially where that act is minor or of little or no consequence. Requiring documentation of such acts would clearly be disproportionate.

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. In respect of proposed changes that are unrelated to our comments above, we note that the term “unethical behaviour” (and related terms such as “ethics-based culture”) is used and it appears that this term relates to the honesty and decency of the employing organisation or client, rather than its compliance with any rules or standards for conduct or practice. The use of the term “unethical behaviour”, where it relates to honesty and decency, should be defined in the Code as it has different meanings and may be interpreted differently in different jurisdictions.

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?*

No, we do not agree with the impact analysis. In particular, the impact analysis states that the magnitude of the impact of a client or employing organisation that faces a reduction in confidentiality arising from a disclosure is "moderate". This considerably understates the magnitude of the impact, as any client or employing organisation that is aware that confidentiality may not be maintained will behave quite differently from the situation where confidentiality will be maintained. The impact of this loss of confidentiality should be described as "high" at least.

PKF International Limited appreciates the opportunity to provide comments and if you have any questions, please do not hesitate to contact me.

Sincerely



Theo Vermaak, Chairman
PKF International Professional Standards Committee

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