

15 December 2012

Jan Munro  
IESBA Deputy Director  
International Ethics Standards Board for Accountants  
International Federation of Accountants  
529 Fifth Avenue, 6<sup>th</sup> Floor  
New York, NY 10017

Dear Ms. Munro,

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

BDO is pleased to have the opportunity to comment on the above exposure draft issued by the International Ethics Standards Board for Accountants (IESBA).

**General comments**

We welcome and support the IESBA's efforts to promote the public interest through improving standards and guidance for all professional accountants on how to respond when encountering a suspected illegal act. In particular, we agree, with certain reservations as detailed below, with the IESBA's proposals regarding the disclosure of suspected illegal acts to management and the escalation, where appropriate, to those charged with governance.

We do not, however, agree that the IESBA should be requiring, in any instances, professional accountants to disclose suspicions of illegal acts to external authorities. The main reasons for this are:

- The mandatory reporting of illegal acts (suspected or actual) should be addressed by local law or regulation. There are many reasons why this approach is desirable, which we expand on below in the answers to your specific questions; however, fundamentally, and as recognised by the Organisation for Economic Cooperation and Development in its 2010 study prepared for the G20, for such disclosure to be effective in practice, there must be appropriate safeguards available to the whistleblower. These safeguards cannot be delivered by the IESBA; rather, they are only capable of being provided through legislation and jurisdictional regulation, which is already the case in many jurisdictions where there are reporting obligations to enforcement authorities.
- Professional accountants are generally not legal experts. The assessment as to whether something is an illegal act is often complex and incapable of being determined without significant further investigation, which requires applicable legal expertise. This problem is further compounded by the fact that a determination is required of the importance of the suspected illegal act in the context of the public interest, a criterion that is not sufficiently clear for practical application. Without statutory protection against legal exposure that professional accountants could face if, in hindsight, they were incorrect in their determinations, we believe that any requirement imposed by the IESBA to disclose to external authorities would likely have little chance of being adopted by member bodies. This would seriously undermine the success of the proposals.

- There is significant public interest value in clients being able to discuss issues with professional advisors in confidence and, indeed, in many jurisdictions this is recognised by the legislation of professional privilege. There is a real risk that the proposals as written will undermine the necessary auditor-client relationship, particularly in the absence of stringent criteria for determining matters that are disclosable to external authorities, as there are many jurisdictions that have such disclosure requirements (e.g., Section 10A under the Securities Exchange Act of 1934).

While we have the aforementioned concerns with the proposal, we believe that the public interest can still be served by the IESBA providing guidance for the professional accountant (1) to report suspected illegal acts to management and potentially to those charged with governance and (2) to encourage the client or employer to report these matters to an appropriate authority.

***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?***

Yes, generally we agree with this requirement; however, there are several important considerations that are not fully addressed by the guidance but are critical to its context and application.

- It is often far from clear what an illegal act is, and this lack of clarity is exaggerated exponentially when many jurisdictions have to be simultaneously considered (e.g., for a multinational entity). Taking reasonable steps to confirm or dispel the suspicion is therefore fraught with problems and exposes the professional accountant to unwarranted risk of criticism.
- There does not appear to be sufficiently clear recognition of materiality. Professional accountants frequently use the concept of materiality in practice. The Exposure Draft indirectly refers to materiality in several ways (e.g., by providing that any obligation must recognise that the professional accountant should exercise ‘professional judgment’ and weigh ‘all the specific facts and circumstances available at the time,’ including ‘the magnitude of the matter’) and recognises that the professional accountant might choose not to pursue a suspicion even though, in hindsight, it might turn out to be of significance). Instead, we believe that the guidance should integrate the concepts of materiality included in the audit literature.

***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?***

No. As mentioned above, we do not agree that professional accountants should be placed in a position whereby they have to consider overriding contractual, professional or legal obligations relating to confidentiality without any related legal protection or safe-harbour provisions. The proposal is unable to create a mechanism that affords such protection or provisions to a professional accountant who breaches a confidentiality requirement arising from either local law or contractual arrangements. To illustrate this dilemma, a number of jurisdictional laws make professional privilege available, usually in a direct response to the public interest. It would be an irresolvable anomaly if the Code required disclosure, yet at the same time professional privilege prevented it. Furthermore, what constitutes ‘appropriate authority’ should be clarified as this is a critical concept.

In our view, the Exposure Draft also introduces a significant risk of reducing the likelihood of preventing and detecting illegal acts, which is counter to its public interest intentions. This may arise as a result of the following:

- Client candor may be discouraged, causing professional accountants difficulty in performing their job to a professional standard (that is the driver for professional privilege noted above, which is often afforded to lawyers, doctors, priests and accountants). This is of particular concern if there are no stringent criteria for determining matters that are disclosable to external authorities.
- Those setting out to subvert the law may merely ensure that professional accountants are kept at a distance and use the services of others who do not have the same stringent reporting obligation.
- A requirement to disclose could cause significant problems for a number of services that are currently delivered by professional accountants. For example, if forensic services are required, entities or lawyers may be reluctant to engage professional accountants to participate on the engagement if they would be required to report suspected illegal acts. This restriction could result in such services being performed by other parties that are not subject to such restrictions, who may be less competent than the accountants.
- A requirement could cause problems for professional accountants working for law firms or within multi-disciplinary practices, in the event of a conflict of codes.

As such, we firmly believe that any such ‘requirement’ or ‘right’ to disclose should only arise by way of a separate requirement outside the Code, based on a national law or regulation.

***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?***

No. As noted above, we do not agree with the proposal for reporting to an external authority. In addition to the reasons noted above, consideration of the public interest is the only concept important enough to override a fundamental principle; however, determining the public interest is fraught with complexity and differs significantly across different cultures.

Although the IESBA attempts to provide guidance by introducing the ‘reasonable and informed third party’ test, this proposal does not currently provide any clear guidance as to what a ‘reasonable and informed third party’ might conclude. We believe that this is far from straightforward; in reality the public interest may reflect the views of various constituencies and stakeholders with different and often competing perspectives. Without clear guidance, it is easier to determine public interest after the fact, which leaves the professional accountant exposed in hindsight for non-disclosure, or indeed for disclosure should it prove to be unwarranted.

***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?***

There is some justification for considering these two situations separately (e.g., the professional accountant providing non-audit services to an audit client may be able to discuss matters with the auditor from his or her firm in a way that he or she would be prohibited from doing, for example, through contractual confidentiality if that auditor were not from the same firm).

However, the current proposals do not clearly describe the reason for treating these parties differently. On the basis that all professional accountants should be subject to the same fundamental principles, this needs to be clarified before we can support such a distinction.

***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?***

No. As described above, we do not agree that the professional accountant should be required to disclose to an external authority.

***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?***

Yes. We believe 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.

***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?***

As noted above, we do not support any form of external disclosure to be included in the Code. Rather we would support guidance for the professional accountant to encourage the entity to report to an appropriate authority suspected illegal acts that affect the entity's financial reporting and acts the subject of which fall within the expertise of the professional accountant. Although we do not support the external reporting aspect of the Exposure Draft, if the IESBA decides to implement it, the professional accountants' responsibilities should be limited to financial reporting issues that fall within their expertise.

***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?***

It would often be beneficial for the auditor to be made aware of a suspected illegal act for audit purposes and in turn the auditor could escalate this within the client. Therefore, in principle, we support disclosure to the external auditor provided that such disclosure would not contravene any legal or contractual duty of confidentiality.

***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?***

No. As noted above, we do not support any form of external disclosure to be included in the Code. Furthermore, we do not discern a substantive difference between a requirement to

disclose and a right to disclose since the Exposure Draft indicates that the professional accountant would be 'expected' to exercise a 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?***

As noted above, we do not support any form of external disclosure to be included in the Code. Rather, as stated above, we would support guidance for the professional accountant to encourage the entity to report to an appropriate authority suspected illegal acts that affect the entity's financial reporting and acts the subject of which fall within the expertise of the professional accountant.

***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?***

For the same reasons as noted in our response to question 8, we would support this, although practically the professional accountant might not have a working relationship with the auditor. In this case, it might be an acceptable alternative to escalate this within the professional accountant's employer's own chain of command.

***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?***

No. As noted above, we do not support any form of external disclosure to be included in the Code.

***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?***

See response to question 7.

***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 noted above, we do not support any form of external disclosure to be included in the Code.

***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 noted above, we do not support any form of external disclosure to be included in the Code.

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

No. The proposals seem disproportional. It should be sufficient to advocate the maintenance of 'appropriate' documentation. Consideration should also be given to the fact that if the professional accountant is subject to legal action in respect of a reported suspicion, the documentation may be legally discoverable in some jurisdictions.

***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?***

No. Given the fact that we do not support fundamental parts of the Exposure Draft, commenting on proposed changes to existing sections of the Code would not be constructive.

***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?***

No. We do not agree with the impact analysis as presented since it does not adequately consider the resolution of high 'negative' impact issues, as described below.

The analysis notes aspects of litigation and retaliation as high impact issues; however, it dismisses them as matters that only the law can solve. This is not a satisfactory resolution of the problem, although perhaps it is symptomatic of the fact that the IESBA is considering fundamental issues over which it has no mandate.

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We reiterate our support for improved guidance for professional accountants in responding to suspected illegal acts. However, we believe this should be accomplished through guidance involving communications with management of the entity and, if necessary, those charged with governance, rather than through disclosure to external authorities, which should instead be governed by local laws and regulations.

Please contact me should you wish to discuss any of these comments.

Yours sincerely,

BDO International Limited

Wayne Kolins  
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