Via email to: janmunro@ethicsboard.org

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International Ethics Standards Board for Accountants

Re: Responding to a Suspected Illegal Act

The Accounting Principles and Auditing Standards Committee ("the Committee" or "We") of the California Society of Certified Public Accountants ("CalCPA") is grateful for the opportunity to comment on the International Ethics Standards Board for Accountants (IESBA) Exposure Draft Responding to a Suspected Illegal Act. The Committee is the senior technical committee of CalCPA. CalCPA has approximately 40,000 members. The Committee is comprised of 49 members, of whom 53 percent are from local or regional firms, 27 percent are from large multi-office firms, 10 percent are sole practitioners in public practice, 8 percent are in academia and 2 percent are in an international firm.

Request for Specific Comments

The IESBA would welcome views on the following 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?

Yes, with such escalation limited to people within the client organization.

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. Although we do not totally equate the accountant/client relationship to the attorney/client relationship, there are sufficient parallels for us to conclude that essentially the same client privilege is appropriate. Accountants, and auditors in particular, must be able to rely on totally open and complete communications with their clients. Once the accountant is either required or permitted to override confidentiality, clients will almost certainly start to guard their communications with their accountants out of fear that the communications will either fall into the hands of prosecutors, or lead the accountant to report the client to prosecutors.

We note that the word "suspected" is absent from this question. Is the presumption that the client has committed an illegal act? This would be absurd as criminal culpability can only be ascertained via a trial.

Also, what does "appropriately addressed" mean? The ED in ¶225.9 talks about investigation, remedial action and steps to reduce the likelihood of a recurrence as though these procedures somehow absolve the entity from dealing with the crime that is suspected; the context is criminal activity that affects the
public interest. This is completely inadequate guidance. The only way to know if the activity is illegal or not is to get a prosecutor involved and then go to trial.

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 is noted in the ED, in various countries around the world, accountants are already under legal obligations to whistleblow under certain defined circumstances. In other words, governments have legislated such requirements where in the judgment of the government such action is in the best interests of the public. This may be fine, but our professional ethics should not expand the whistleblowing obligation beyond that which is already a matter of law.

**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. An illegal act is an illegal act. If an accountant is to have certain responsibilities regarding suspected illegal acts, why should those responsibilities be different depending on the nature of the service provided?

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. **The entire foundation on which this ED is constructed is a house of cards.** The question of legality is ultimately determined in a court of law, in many cases only after years of investigation and prosecution. Requiring an accountant to act based on suspicions imputes to the accountant knowledge that IS ALWAYS far outside the accountant's expertise, e.g. Is there sufficient evidence to prosecute? Is there sufficient evidence to obtain a conviction? Such questions are beyond the scope of any accountant's ability to answer.

Moreover, accountants are not lawyers and as a matter of law, at least in certain countries, practicing law without a license is itself a criminal offense. How can our ethics possibly contemplate requiring an accountant to practice law by requiring the accountant to give a client legal advice, especially legal advice about a possible criminal act? This is an unconscionable idea.

So, what should an accountant do when faced with suspicions about possible illegal acts that have been communicated to the client at all levels and the client has not responded? The accountant should consult with his/her own legal counsel and withdraw from the engagement.

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?

As is evident in previous responses, we think this entire ED never should have seen the light of day, but in the context of its requirements, my answer is "yes".

We can only read between the lines as to why the authors of this ED would propose that auditors bear a greater responsibility than accountants in general. It may be more likely that auditors are more likely to uncover suspected illegal acts because of the nature of an audit vs. other professional services provided by accountants to clients, but this not clearly the case.
Accountants providing tax services would seem to be in the position of being likely to encounter suspected illegal activity, or do the authors of the ED consider tax evasion not to be an illegal activity?

In any case, if the ED addresses accountants’ ethical behavior, it matters not at all what kind of services are being provided. If the accountant encounters a suspected illegal act s/he has to deal with it.

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. Why should it matter whether the suspected illegal act has anything to do the accountant’s professional expertise? Perhaps the accountant sees obviously drunk or otherwise impaired people getting behind the wheel of vehicles, or operating heavy equipment; clearly a danger to the public. Why shouldn’t the accountant be required to act? Perhaps the accountant has come across evidence that the stated operating capacity of some product is less than what is advertised, creating mortal danger to a user operating the device at the advertised capacity? Such matters may not be within the accountant’s expertise and yet a suspicion of an illegal act has occurred would be warranted. Why should the accountant be exempted from following the ED on such matters?

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 external auditor is not an appropriate authority. Whether there is another firm that is the auditor, or if there is no auditor, the auditor is in no better position to deal with a recalcitrant client the non-auditor professional accountant.

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. See last paragraph of response to question 5.

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. See answer to question 7. No matter how you slice it, the accountant rarely, if ever, has sufficient expertise to determine whether an illegal act has been committed.

More to the point, even if the accountant could determine that an illegal act has been committed, is that of any value if a criminal indictment and conviction cannot be obtained? Do the authors of the ED really expect clients to just confess to authorities because their accountant has raised a concern about a suspected criminal act, so prosecutors can skip trials and move directly to the courtroom for sentencing by a judge?

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. There are problems at so many levels it is hard to know where to begin. As noted in our response to question 8, the auditor is not the party to deal with the matter.

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?

Yes. Every member of society, with the exception of those that as a matter of law or professional ethics cannot do so, has the right to report illegal activity to authorities. We don’t see employees in quite the same light as we see independent accountants. To preserve a person’s or an entity’s right to representation, an independent accountant’s confidentiality privilege must be preserved, at least to the maximum extent permitted by law. An employee should not have his/her hands tied in this respect.

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. Are we talking about the public interest or not? The public interest is not limited in this fashion.

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?

We’ve already taken the position that this entire ED is misguided, and that the accountant should not be so required in any circumstances except as required by law, but we will address the exceptional circumstances referred to throughout the ED as a concern for threats to physical safety.

This is way too high a threshold. Whose physical safety? The accountant’s? His/her family? His/her pets? What about threats to personal property? Livelihood? Reputation? Harassment?

When society makes it a crime for all its citizens to report suspected criminal activity, accountants will be so obliged. Until that time, setting accountants up to shoulder this load, the costs to the accountant notwithstanding, is, dare we use the word again, unconscionable.

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?

See answer to #14.

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

¶225.23 refers to reporting to the appropriate authority. Absent this reference, the documentation requirement is fine.

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?

Yes.
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: it is a whitewash, presenting only the perceived benefits and none of the downside. Also, we think it is disingenuous in that the ED limits the crimes to be reported and provides a complete exemption where there is fear for physical safety.

We would be glad to discuss our opinions with you further should you have any questions or require additional information.

Sincerely,

[Signature]

Howard Sibelman, Chair
Accounting Principles and Auditing Standards Committee
California Society of Certified Public Accountants