



20 December 2012

Mr Ken Siong
Technical Director
International Ethics Standards Board for Accountants
International Federation of Accountants
545 5th Avenue, 14th Floor
New York, New York 10017, USA

By email: kensiong@ifac.org

Dear Mr Siong

Re: Exposure Draft on Responding to a Suspected Illegal Act

Thank you for the opportunity to comment on this Exposure Draft. CPA Australia is one of the world's largest professional accounting bodies, with a membership of more than 139,000 finance, accounting and business professionals and leaders in 114 countries. Our vision is for CPA Australia to be the global professional accountancy designation for strategic business leaders. We make this submission on behalf of our members and in the broader public interest.

General Comments

CPA Australia does not support the imposition of a requirement to override confidentiality and disclose a suspected illegal act in the absence of a regulatory framework which would offer protection. As it is not possible for the Code to provide such protection, we are of the opinion that a requirement to disclose should only be imposed by an appropriate legal framework that offers protection simultaneously from civil and criminal liability and protection from retaliation.

The imposition of a requirement to disclose (a positive duty) that may be of high risk, cost and have other severe consequences requires that consideration is given not only to the act and its consequences but also to the capacities of the person who is required to make the disclosure. Such attention is not required when imposing negative duties (duties not to harm). Generally, there is little support for imposing general positive duties, such as the ones proposed in this exposure draft that require the consideration of every suspected illegal act and of everyone that may be affected, particularly when such duties will potentially be harmful for those upon which they are imposed. This does not mean that professional accountants do not and should not disclose suspected illegal acts but they should exercise their right to do so, based on their professional judgement.

CPA Australia is of the opinion that the intended and unintended consequences of the proposed amendments to the Code need to be considered more adequately. The Explanatory Memorandum (EM) and the Impact Analysis assert that the public interest will be better protected and commentary is provided of how these changes are expected to promote the public interest. We believe a considered analysis is required of the negative and positive consequences (to the extent that they can be identified and assessed) of the proposed requirements. The likely effect these proposals will have on the relationship between professional accountants and their clients or employers needs to be evaluated. We understand that our members play an important role in educating their clients and organisations to improve their legal compliance and ethical behaviour. They also are fundamental in introducing systemic changes to reduce risks of illegal activities. The impact these proposals will have on our members' ability to fulfil these roles needs to be understood and a more accurate assessment of the possible consequences ascertained. The effect of possible erroneous disclosures should also be considered in evaluating the impact on the public interest.

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We encourage IESBA to consider the moral and legal implications of the imposition of the requirement to disclose a suspected illegal act, as well as how the proposed changes align with the Code's framework which is principles and professional judgement based. There is a difference between offering guidance on how to deal with threats to the fundamental principles and, as is happening in this case, offering prescriptions when the fundamentals of confidentiality and the public interest may conflict (when there is an actual dilemma). The imposition of the requirement to disclose, in all circumstances except when threats to physical safety exist, extends beyond ethical behaviour into the realm of altruism. According to the proposal the requirement to disclose overrides any other duties and obligations professional accountants may have and we question whether it is appropriate for the Code to do that.

We are of the opinion that the Code should provide guidance on what professional accountants should consider when making professional judgements that may require them to override confidentiality in order to act in the public interest. We are concerned that the approach adopted in the proposed changes, which expects altruistic behaviour, could undermine the authority and acceptance of the Code.

Given the inability of the Code to afford protection and the lack of adequate consideration of the consequences of the proposed requirements for the profession, the professional accountant and the public interest, CPA Australia does not support the imposition of a mandatory requirement to override confidentiality and disclose a suspected illegal act on any professional accountants. We are of the opinion that IESBA should develop guidance on how the right to override confidentiality could be exercised in order to make a public interest disclosure.

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?*

CPA Australia is of the opinion that a professional accountant should use professional judgement to deal with a suspected illegal act.

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?*

As outlined in our general comments, we are of the opinion that a professional accountant should have the right to override confidentiality and disclose certain illegal acts to an appropriate authority but not a duty or a requirement to do so.

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?*

CPA Australia is of the opinion that the right to override confidentiality and report to an external authority should be based on the public interest. However, while the public interest test appears to be appropriate, we can identify several difficulties with its operationalization, as the ability to accurately identify and calculate possible consequences and therefore be able to defend disclosure is a difficulty that professional accountants will face.

IFAC defines public interest as: 'the net benefits derived for, and procedural rigor employed on behalf of, all society in relation to any action, decision or policy'. The proposed changes to the Code appear to be based on the assumption that disclosure of suspected illegal acts will result in net benefit. As mentioned in the general comments, it is not clear whether this assumption can be verified as an explicit consideration of the costs, benefits and competing duties is not evident. The approach adopted also appears to be based on the assumption that certain costs can be justified for the achievement of a net benefit but it is not clear who has the right to decide who will bear such costs.

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?*

CPA Australia is of the opinion that the standard for all professional accountants should be the same and every professional accountant should have the right to make a public interest disclosure of a suspected illegal act. As mentioned in our general comments, we are of the opinion that any requirement to disclose should be imposed by the law and not by the Code, because it is only the law that can offer protection from liability and retaliation to professional accountants.

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?*

Please see our response to question 4.

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?*

Please 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?*

CPA Australia does not support the imposition of a requirement to disclose to an external authority.

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?*

Please see our response to question 4.

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?*

As mentioned in our general comments we support the right to override confidentiality but not the requirement to do so. Further, we question whether an expectation can be imposed on what a professional accountant is to do with a right. Attaching a requirement on a right is not consistent with the concept of a right.

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?*

CPA Australia is of the opinion that accountants should have the right to make public interest disclosures about acts that relate to the subject matter of the professional services being provided but no requirement to do so.

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?*

CPA Australia is of the opinion that disclosure to the external auditor should be a right and not a requirement.

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?*

CPA Australia is of the opinion that all professional accountants should have the right to override confidentiality to make public interest disclosures but whether they exercise such a right needs to be based on individual professional judgement.

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?*

CPA Australia is of the opinion that professional accountants should have the right to disclose acts that relate to the employing organisation's financial reporting and acts the subject matter of which falls within the expertise of the professional accountant, without a requirement or expectation to do so.

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?*

CPA Australia does not support the imposition of a requirement to disclose to an appropriate authority.

Further, the proposed exceptional circumstances that may remove the expectation to disclose to an external authority appear to be based on the assumption that professional accountants will be in a position to assess threats in advance or that possible forms of retaliation will be evident to them prior to any disclosure. The experience of many whistleblowers does not support this view, regardless of whether there is an organisational policy or law against retaliation.

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?*

Please see our response to question 14.

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

The proposed guidance describes illegal acts broadly as 'acts of omission or commission, intentional or unintentional, committed by an employing organisation, or by those charged with governance, management or employees of an employing organization which are contrary to the prevailing laws or regulations. Personal misconduct unrelated to the business activities of the entity is excluded'.

The proposed guidance requires professional accountants providing professional services to non-audit clients and professional accountants in business to identify, confirm, report internally, report to an external auditor (if one exists) and advise the organisation to disclose illegal acts to an external authority. If the response from the organisation is not appropriate then the accountant, if it is in the public interest, has a right to disclose to an external authority and is expected to do so. However, the proposals provide this 'required' right only in relation to:

- Suspected illegal acts that directly or indirectly affect the client's or employing organisation's financial reporting.
- Suspected illegal acts the subject matter of which falls within the expertise of the professional accountant.

Despite the fact that only these illegal acts can/should be disclosed to an external authority the proposed process and the documentation requirements apply to all illegal acts. This we think imposes an enormous burden on professional accountants that is unjustified and imposes obligations that extend the scope of employment or engagements, without the agreement of the employer or client.

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?*

CPA Australia does not agree with the proposed changes to the existing sections of the Code that impose a requirement or expectation to override confidentiality.

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?*

As discussed in the general comments, CPA Australia is of the opinion that, the impact analysis presented in relation to the 'public interest' needs to be developed more adequately.

Additional Comments

Notwithstanding our strong concerns with the fundamental concepts that underlie the proposed approach we offer some additional comments for IESBA's consideration.

Terminology

CPA Australia is of the opinion that the terminology used in the proposal requires more clarity and appears to be incongruent with that adopted in the Code, as well as the commonly accepted understanding of terms.

The term 'illegal acts' is used but it is not clear whether the term refers to criminal and civil law or only refers to acts that infringe criminal law. The description of illegal acts offered in paragraphs 225.1 and 360.1 suggests that all acts and not only those that contravene criminal law are included. We suggest that IESBA clarifies this issue as we consider it important that professional accountants know the laws and regulations this guidance is addressing.

A relevant consideration relates to the expressed or implied term of confidentiality contained in employment contracts. It is not clear from the proposal whether professional accountants in business would be expected to breach their contractual obligations and bear the civil liability for doing so in order to disclose a suspected illegal act. If that is the case, the Code would potentially be requiring professional accountants to breach their common law obligations in order to comply with its requirements.

Further, the distinction is made between a requirement to disclose and a right to disclose. For example, it is proposed that Members in Business will have a requirement to disclose to an external auditor, if there is one, and a right to disclose to an external authority. The proposed guidance states that they are expected to exercise this right to disclose. Paragraph 100.5 and 140.1 of the Code in relation to confidentiality state that information should not be disclosed 'unless there is a legal or professional right or duty to disclose'. Generally, a right is a demand placed on others by the person possessing it while a duty is a demand placed on persons who have it. The proposal imposes a requirement and a right. We question whether it is possible to impose the expectation that a right is exercised and whether the Code can impose expectations on professional accountants as to what they should do with their rights. Paragraph 100.4 of the Code states that 'the use of the word "shall" in this Code imposes a requirement on the professional accountant or firm to comply with the specific provision in which "shall" has been used.' We therefore question why the word 'shall' has not been used in line with the Code's adopted terminology.

Objective

It is not clear whether the motivation of this proposal is to address illegal acts, to report illegal acts or achieve both. Paragraph 360.7, for example, lists the sort of factors that need to be considered:

'When determining if the response to the matter is appropriate the professional accountant shall consider the nature and magnitude of the matter and factors such as whether:

- The matter has been adequately investigated;
- Remedial action has been taken to address the matter; and
- Appropriate steps have been taken to reduce the risk of re-occurrence, such as for example, additional controls or training.'

The proposal suggests that even if the response to the matter is appropriate, the professional accountant would still be required to disclose to the external auditor and an external authority. There seems to be a distinction between disclosure of illegal acts and addressing illegal acts that is not sufficiently developed, making the proposed paragraphs lack coherence and order. It appears that professional accountants would have to follow through on two fronts:

- address the illegal act and see what has been done to minimise reoccurrence, and
- make sure the client discloses to appropriate authority or else the professional accountant makes the disclosure.

Obtaining Advice

Paragraphs 225.8 and 360.13 suggest that professional accountants may consider it appropriate: 'to discuss the matter with the relevant professional body on an anonymous basis or with a legal advisor under the protection of legal privilege to assist in determining the appropriate course of action'. It is possible that the legal advisor may be of the opinion that the matter should not be disclosed. If that is the case, professional accountants should be able to adopt such an opinion if they consider it appropriate, otherwise the value of gaining expert opinion is not evident.

Enforcement

In relation to enforcement and discipline, it may be possible to hold someone responsible for not disclosing when a professional accountant is confronted with a 'smoking gun' and does not disclose. It is not clear how the requirement to disclose based on 'reasonable suspicion' can be enforced.

The proposal also does not address how acts that may be illegal in one jurisdiction should be addressed by network firms if they are legal in another.

Explanatory Memorandum

In addition to our concerns about the content of the proposal, we would also like to bring to the attention of IESBA some concerns we have about the language and sentiments expressed in the EM.

In relation to IESBA's consideration of factors supporting a requirement to disclose, the EM states that IESBA considered that 'requiring disclosure will result in disclosure occurring more consistently in these situations than providing a right to disclose because there will be less discretion for the accountant to determine whether to disclose.' Given that a fundamental characteristic of the accounting profession and IESBA's Code is professional judgement, this view appears to contradict the existing framework and conflict with the Code and its conceptual framework. It can also be understood as expressing some underlying assumptions about professional accountants which could be concerning as they suggest that discretion should be limited and rules should be imposed instead of the principles and judgement based approach that is the foundation of the Code.

On the relationship between the professional accountant and the non-audit client or employer the EM states: 'The IESBA is of the view that imposing a requirement on other professional accountants in public practice and professional accountants in business would not be consistent with the role of such professional accountants which is more of a fiduciary nature towards the client and employer. In addition, a professional accountant providing services to a non-audit client may not have appropriate access to management or those charged with governance to adequately escalate the matter.' It is not clear what is the meaning of 'consistent with the role of such professional accountants' and whether IESBA's view is that disclosing to the external auditor does not affect the fiduciary relationship. Our opinion is that this comment in the EM can be perceived as contradictory to the proposed requirements which in fact impose an expectation to disclose.

The EM further states: 'However, the IESBA is of the view that for smaller entities which have no external auditor, there is a low probability of occurrence of illegal acts of such consequence and as such is of the view that such circumstances would be rare.' We question the validity of IESBA's view and whether this view then indicates that disclosure is only required for entities that have an external auditor. If this is indeed the case, IESBA may wish to consider developing guidance for public interest entities only.

If you have any questions regarding this submission please do not hesitate to contact Dr Eva Tshuridu, Policy Adviser Professional Standards and Governance, at eva.tsahuridu@cpaaustralia.com.au.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Alex Malley', with a stylized flourish at the end.

Alex Malley FCPA
Chief Executive Officer