Ken Siong
IFAC
545 Fifth Avenue
14th Floor
New York
NY 10017
USA

15 January 2013

Dear Mr Siong

Exposure Draft – Responding to a Suspected Illegal Act

The Financial Reporting Council (FRC) welcomes the opportunity to comment on the proposed changes to the Code of Ethics for Professional Accountants (the Code) set out in the above exposure draft.

We agree that how to respond to suspected illegal acts is an important consideration for professional accountants, and that there can be circumstances where the principle of confidentiality may be appropriately overridden subject, as indicated in the exposure draft, to compliance with any applicable legal or regulatory requirements. However, we have some comments on the proposals in the exposure draft, in particular in relation to the proposed role and responsibilities of the external auditor.

ISA 250 addresses the auditor’s responsibility to consider laws and regulations in an audit of financial statements. There are a number of areas where considerations under ISA 250 overlap with those set out in the exposure draft, for example:

- Proposed paragraph 225.5 in the exposure draft and paragraph 18 of ISA 250 which both relate to action to be taken on becoming aware of suspected illegal acts;
- Proposed paragraphs 225.6 and 225.7 in the exposure draft and paragraphs 19 and 22 of ISA 250 which relate to discussing the matter with the appropriate level of management and those charged with governance; and
- Proposed paragraphs 225.10 and 225.11 in the exposure draft and paragraph 28 of ISA 250 which relate to reporting suspected illegal acts to parties outside the entity.

We would consider it unhelpful if there were to be requirements addressing the same issues in two separate sets of standards that may both be applicable to auditors that, whilst not apparently contradictory, are also not fully consistent. We recommend that the IESBA works with the IAASB in taking forward its initiative to ensure that there is co-ordination of the finalisation of the ethical requirements with the ISAs.

With respect to the specific proposals in the exposure draft, we welcome the proposal that auditors should be alerted to actual or suspected illegal acts that may be material to the financial statements. However, it is not appropriate for the external auditor to be established
as the default party to which a professional accountant should disclose any concerns in circumstances where that accountant is unable to escalate the matter within the entity or has doubts about the integrity or honesty of management and there is no established mechanism for reporting such matters such as an ethics hotline (as proposed in paragraph 360.6). Whereas doubts about the integrity of management may be relevant to the auditor’s role, this proposed requirement also risks the auditor having to deal with vexatious reports and/or matters that are not relevant to the audit of the financial statements and are outside the auditor’s expertise. Further, having to deal with reports that are not relevant to the audit may detract the auditor’s focus from matters that are relevant. It is not appropriate to extend the role and responsibilities of the auditor in this way, through an ethical code, rather than through law or regulation.

Further, we question why under paragraph 360.8, which addresses disclosure to an appropriate authority in the public interest where the employing organisation does not make adequate disclosure, the professional accountant is required to disclose the matter to the external auditor but not direct to the authority. This could have adverse consequences such as an unacceptable delay in the authority being informed as the external auditors will need to undertake their own investigations before reporting to that authority. If an appropriate regulatory or enforcement authority exists the professional accountant’s obligation should be to disclose concerns direct to that authority rather than use the auditor as a conduit. It would, however, be helpful if the auditor were informed of any such reports, or other concerns considered relevant to the audit of the financial statements. This could be addressed by requiring the professional accountant to disclose these more limited matters to the auditor, subject to the professional accountant not breaching any legal, regulatory or contractual confidentiality requirements.

When a professional accountant determines that the suspected illegal act is of such consequence that disclosure to an appropriate authority directly would be in the public interest the professional accountant should make such disclosure, subject to complying with any relevant legal and regulatory requirements. This should apply regardless of whether “the subject matter of the illegal act falls within the expertise of the professional accountant”. If the professional accountant has doubts as to whether making a report is appropriate they may seek legal advice. Paragraphs 225.13, 225.19 and 360.9 should be amended to reflect this.

We also question the proposal in paragraph 225.9 that, when determining whether [management’s] response to a matter is appropriate, the professional accountant shall consider factors such as, inter-alia, whether “appropriate steps have been taken to reduce the risk of re-occurrence”. The auditor may not have the necessary skills or experience to assess the ‘appropriateness’ of steps taken to avoid repeat offences.

Yours sincerely

Nick Land
Director of the FRC and Chairman of the FRC’s Audit & Assurance Council
About the FRC
The Financial Reporting Council is the UK’s independent regulator responsible for promoting high quality corporate governance and reporting to foster investment. We promote high standards of corporate governance through the UK Corporate Governance Code. We set standards for corporate reporting and actuarial practice and monitor and enforce accounting and auditing standards. We also oversee the regulatory activities of the actuarial profession and the professional accountancy bodies and operate independent disciplinary arrangements for public interest cases involving accountants and actuaries.