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4 September 2015

By email: kensiong@ethicsboard.org

Mr. Ken Siong
Technical Director
International Ethics Standards Board for Accountants
529 Fifth Avenue, New York
NY 10017

Dear Mr. Siong

IESBA Exposure Draft: Responding to Non-Compliance with Laws and Regulations
("NOCLAR")

We continue to support the IESBA's efforts to provide guidance in the 'Code of Ethics for Professional Accountants' regarding the actions a professional accountant ("PA") should take in relation to NOCLAR.

We have significant concerns, however, about the scope of the proposed guidance set out in the exposure draft. The proposed guidance sets out prescriptive rules specifying the actions that PAs should take in relation to all types of NOCLAR except those which are "clearly inconsequential". The result of this is that responsibilities are placed on PAs to take action in respect of a full range of NOCLAR including the vast majority of which are not "clearly inconsequential" but are not so significant that they cannot be resolved, in most cases, by the PA exercising his/her professional judgment as to the correct course of action. It is arguable whether guidance on such matters is needed, but if it is considered useful, we recommend that it should be developed separately from guidance relating to NOCLAR which pose a threat to the public interest.

The primary focus, in our view, should be on developing robust, principles-based guidance for PAs on how to identify, and what action to take in respect of NOCLAR which have significant implications for the public interest. We consider that the "substantial harm" threshold is probably appropriate in determining whether there is a threat to the public interest, and guidance on identifying, assessing and taking appropriate action on the threat in this context would be more useful than trying to cover NOCLAR which do not pose a threat to the public interest in the same document.

Chairman The Hongkong and Shanghai Banking Corporation Ltd
Vice Chairmen Bank of China (Hong Kong) Ltd
Standard Chartered Bank (Hong Kong) Ltd
Secretary Henry Chan

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秘書 陳崇禧



We have set out our comments on the specific questions posed in the exposure draft in the appendix to this letter. We request that those comments are read in the context of the concerns expressed in this letter.

We would be happy to further clarify or discuss any of our comments should you so wish.

Yours sincerely

A handwritten signature in black ink, appearing to be 'Henry Chan', is positioned above the printed name.

Henry Chan
Secretary

Encl.

IESBA Exposure Draft
Responding to Non-Compliance with Laws and Regulations (“NOCLAR”)
HKAB Comments on Specific Questions

Question 1

Where law or regulation requires the reporting of identified or suspected NOCLAR to an appropriate authority, do respondents believe the guidance in the proposals would support the implementation and application of the legal or regulatory requirement?

Where there are regulatory or legal requirements to report NOCLAR, then these override the ethical duty of confidentiality. As such requirements need to be followed strictly in accordance with the law and/or regulations in a given jurisdiction, we consider that it is not useful for the proposed guidance to cover this in detail, as it would, in most if not all cases, be appropriate for the PA to seek legal advice.

Question 2

Where there is no legal or regulatory requirement to report identified or suspected NOCLAR to an appropriate authority, do respondents believe the proposals would be helpful in guiding PAs in fulfilling their responsibility to act in the public interest in the circumstances?

We believe that the proposals, as drafted, would result in Professional Accountants (“PAs”) taking unnecessary action on actual or suspected NOCLAR that are more serious than “clearly inconsequential” (a threshold which we believe is too low) but less serious than causing “substantial harm”. In all such cases, the proposed guidance sets prescriptive rules for specific actions to be taken by PAs. We consider that the guidance should be shorter and more principles-based than the proposals in the ED.

We believe that the proposals, as drafted, would result in PAs taking on an unnecessary, and possibly inappropriate, level of responsibility in respect of many matters that are either of little significance, or that are being appropriately addressed within the organisation (for example, by a compliance or legal department).

Question 3

The Board invites comments from preparers (including TCWG), users of financial statements (including regulators and investors) and other respondents on the practical aspects of the proposals, particularly their impact on the relationships between:

- (a) Auditors and audited entities;*
- (b) Other PAs in public practice and their clients; and*
- (c) PAIBs and their employing organizations.*

As discussed in our response to Question 2, we believe that the threshold at which PAs become required to take action is too low to be practicable, and the prescriptive nature of the guidance relating to such action is likely to result in a significant amount of not serious (but more than “clearly inconsequential”) issues being escalated to top management and TCWG by PAs even if the organisation has established processes for dealing with and reporting such incidents which do not need to involve PAs.

The proposed guidance carries the risk of turning PAs into “policemen” for the whole organisation, whenever they become aware of relatively insignificant actual or suspected NOCLAR or NOCLAR which “may” occur in the future. This would likely result in serious NOCLAR being obscured by the reporting to top management and/or TCWG of numerous relatively insignificant issues. This is unlikely to enhance focused or constructive relationships of the kinds set out in the question.

Question 4

Do respondents agree with the proposed objectives for all categories of PAs?

We believe that the objectives are far too broad. The guidance should be focused on matters that involve the public interest, which by their nature, could be expected to cause substantial harm to the interests of the organisation, investors, creditors, employees or the wider public. Instead, the proposed guidance places responsibilities on PAs in respect of all NOCLAR that are not “clearly inconsequential”, and as such detracts from the public interest aspects.

Question 5

Do respondents agree with the scope of laws and regulations covered by the proposed Sections 225 and 360?

We agree with the scope of laws and regulations in these sections, but we believe that the focus of the proposed guidance should be on providing principles-based guidance for situations involving serious matters that relate to the public interest.

Question 6

Do respondents agree with the differential approach among the four categories of PAs regarding responding to identified or suspected NOCLAR?

We see some merit in the differential approach, although if the guidance were to be focused on threats to the public interest, then a lot of the prescriptive guidance contained in the ED would be inappropriate and unnecessary.

Question 7

With respect to auditors and senior PAIBs:

(a) Do respondents agree with the factors to consider in determining the need for, and the nature and extent of, further action, including the threshold of credible evidence of substantial harm as one of those factors?

We believe that the threshold of “credible evidence of substantial harm” is appropriate for determining what may be a threat to the public interest. In our view, this should be the focus of the guidance.

(b) Do respondents agree with the imposition of the third party test relative to the determination of the need for, and nature and extent of, further action?

The third party test could be used a sense check by PAs in assessing whether their proposed actions are adequate. It is, however, important that this test is not framed in such a way as to enable it to be used by third parties to second guess the PA’s judgment and decisions after the event. This could presumably leave the PA open to claims and litigation that would not be just.

(c) Do respondents agree with the examples of possible courses of further action? Are there other possible courses of further action respondents believe should be specified?

Please refer to our comments above in respect of the focus of the guidance needing to be on matters that are threats to the public interest.

(d) Do respondents support the list of factors to consider in determining whether to disclose the matter to an appropriate authority?

To the extent that the matter is a matter of public interest, and subject, in all cases, to the PA seeking appropriate legal advice, we support the list of factors referred to.

Question 8

For PAs in public practice providing services other than audits, do respondents agree with the proposed level of obligation with respect to communicating the matter to a network firm where the client is also an audit client of the network firm?

We believe that the guidance should be limited to suggesting appropriate courses of action in matters involving threats to the public interest.

Question 9

Do respondents agree with the approach to documentation with respect to the four categories of PAs?

If the guidance were to be limited to matters involving the public interest, we believe that the PA, regardless of the category, should seek legal advice on the appropriate level of documentation.