



**The Institute of
Chartered Accountants
of Pakistan**

HEAD OFFICE

Technical Director
IESBA
New York, USA

December 14, 2012

Subject: COMMENTS ON EXPOSURE DRAFT 'RESPONDING TO A SUSPECTED ILLEGAL ACT'

Dear Sir,

The Institute of Chartered Accountants of Pakistan welcomes the opportunity to offer comments on the above mentioned Exposure Draft.

Please find enclosed the comments of the relevant Committee of the Institute for your perusal.

If you require any further clarification, please do not hesitate to contact us.

Yours faithfully,

Haroon Tabraze
Director Technical Services
The Institute of Chartered Accountants of Pakistan
haroon.tabraze@icap.org.pk

(Established under the Chartered Accountants Ordinance, 1961-X of 1961)

**Chartered Accountants Avenue, Clifton, Karachi-75600 (Pakistan) Ph: (92-21) 111 000 422 Fax: 99251626
Website: <http://www.icap.org.pk> E-mail: info@icap.org.pk**

ICAP COMMENTS ON IESBA EXPOSURE DRAFT 'RESPONDING TO A SUSPECTED ILLEGAL ACT'

GENERAL COMMENTS

The foregoing conclusions prescribe conditions where the professional accountant either has an *'obligation'* to, or is given a *'right'* to, override the fundamental principles of confidentiality and disclose a suspected illegal act at different appropriate levels, where professional accountant determines that doing so is in *'public interest'*.

The proposed changes are expected to result severe theoretical and conceptual changes to the ethical requirements which might eventually impact the professional accountant's public image adversely. The professional accountants going forward may erroneously be considered detectives or law enforcement investigators, which in fact is beyond their key roles. All Professional Accountants are neither necessarily the qualified Forensic Reviewers nor should be considered the experts in all the legal disciplines. Overriding the confidentiality principle would in most of the cases entail vigorous legal counseling due to a number of expected conflicts with the local laws of a given jurisdictions. The professional accountant will have to observe if the local laws, and their expected usage, directly or indirectly prohibit deviating from confidentiality principle and the circumstances where the professional accountant may be exposed to legal consequences in overriding the confidentiality requirements.

Although all illegal acts presumably have a consequence on the financial reporting, yet, the professional accountants especially those in public practice may discover certain illegal acts which may not be having significant grave financial impacts and as such may not be affecting their core assurance responsibilities. Further, as the professional accountant should not be considered to have all legal expertise, there may be many illegal acts on which the professional accountant may not be in a position to raise questions or make conclusions.

While defining and refining the ethical responsibilities of professional accountants globally, there is also a need to consider the economic, legal and other issues faced by the professional accountants that vary considerably from jurisdiction to jurisdiction. There are no two opinions that the Professional Accountants should be ethical, elegant and disciplined and follow best moral practices in safeguarding the public interest, however, making such disclosures at an escalated level can result in continuing legal consequences for the professional accountant even if a fatal reaction is considered to be remote. This would necessitate for every professional accountant in practice or business to obtain specific and general indemnity insurance covers and hire the services of full time legal advisors which of course would be devoid of economic justification for the professional accountants in majority of the cases. A number of economies are going through a phase of rigorous recession where unemployment is the biggest menace for the governments. The conclusion taken by ED that "commercial consequences to the professional accountant or others are not sufficient ground to warrant justification for not disclosing" sounds ethical and principled, however, it does not take into account the economic and sentimental truth where a competent, ethical and complaint professional accountant would make not only a loss of his job, rather a loss of his entire career, on making disclosure of the suspected illegal happenings. Such a professional accountant working in emerging and small economies would get a media fame and every next employer would avoid recruiting him regardless of his abilities. As per findings of Transparency International very few countries are free of severe corruption. Corruption in itself is an awful illegal act but at a number of jurisdictions the speed moneys and bribes have become the cost of doing business and an unavoidable reality for the entrepreneurs and businesses. ED does not appear to have properly taken into account such bitter business realities on the globe, specially the emerging economies.

While fully acknowledging and appreciating that the best ethical practices must be followed without a fail, I fear that the ED would cause over-assertive requirements which would result in frequent legal complications, invoke recurring proceedings under defamation laws in certain jurisdictions, ruin the watchdog image of the professional accountant thereby labeling the professional accountant as 'James Bond', and create a huge trust deficit for the professional accountants specially in advisory roles. This would not only result in specific job and career loss incidents, rather would generally divert the client confidence towards other service providers which going forward would be detrimental to the accountancy profession in itself in a world of the survival of the fittest only.

We believe, the obligatory requirements of disclosures of suspected illegal acts at escalated level should be narrowed down, and there should be more extensive guideline material in the ED with respect to the conditions where professional accountant has either an obligation or a right to report the illegal acts. A wider study should be carried out about variant legislative requirements at different jurisdictions and all the possibilities should be taken into account before concluding the ED.

The ED should provide further clarity and definitive basis to determine and conclude that what exactly is the 'Public Interest'. Further, there should be more extensive guidelines as to identifying and establishing a 'suspected illegal act' which can affect the 'public interest'.

SPECIFIC COMMENTS IN RESPONSE TO THE QUESTIONS ASKED

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?

Reply

Professional accountant has certain established areas of responsibility e.g. audit or assurance or non-assurance services etc and his objective and role while providing these services is explicitly clear in the light of different pronouncements. The professional accountant is not a legal expert having insight of all the legal requirements within a jurisdiction; therefore, he must not be construed to have a primary role of identifying all the illegal acts regardless of the nature of services being provided.

In my view, where the professional accountant is providing audit services and during the normal course of his audit work he discovers a suspected illegal act having repercussions related to financial reporting or accounting, and the procedures applied by him do not remove the suspicion, the professional accountant should discuss the matter with the management at an appropriate level to obtain further clarity, explanation or justifications. If no appropriate response is received, the matter should be escalated to the extent the response is not appropriate, and such escalation should be made up to the level of those charged with governance or ultimately to the legal stakeholders of the organization. **For escalating such matter to the appropriate Authorities, the Professional Accountant must be allowed to take a prior written legal advice, and the matter should be escalated only where such legal advice urges the professional accountant to do so thereby providing the due legal comfort to the professional accountant for making such a disclosure.** Such an advice may be sought from a renowned Law Practitioner, and the professional accountant should make sure that he keeps the references of his client confidential or signs a Non-Disclosure Agreement with the Law Practitioner before sharing the information. In my view, if the professional accountant, based upon legal advice, concludes that it would not be appropriate to escalate the matter to appropriate Authorities, he should be permitted to avoid it, by keeping on record all the circumstances and ensuring the completeness of documentation. However, if the professional accountant also concludes that such a suspected illegal act could be severe and can affect the public interest, while the legal advice does not support escalating the matter to appropriate authorities, the professional accountant may have to withdraw from the engagement.

Further, as mentioned earlier, more clarity should be provided as to what constitutes the 'public interest' and which illegal acts can affect the 'public interest' that pertain to the role of a professional accountant in a given engagement of audit or assurance or non-assurance services, and how their severity has to be measured by the professional accountant for deciding the appropriate course of action. I believe all the illegal acts cannot be discovered, identified and investigated by a professional accountant and where such a suspected illegal act is not concerning the domain of responsibilities of the professional accountant in an engagement, he should not be held responsible to investigate, conclude or escalate the matter up to the appropriate Authorities. In all such unrelated matters, the Professional Accountant's responsibility should be to report them to those charged with governance.

In case of other services provided to non-audit clients e.g. advisory on tax or corporate matters, where professional accountant has to appear before certain public tribunals or judgment forums, the professional accountant should have to follow the same confidentiality measures with which the legal counsels are privileged in

connection with the information shared by their clients. He should only be required to escalate such matter of suspicion to those charged with governance or in a severe case to withdraw from the engagement. Professional accountant may have to seek legal advice in such cases as well.

A professional accountant in job or business should only disclose / report the suspected illegal act to his immediate next authority as per managerial hierarchy of an organization, in case this comes under his specified official duties. However, professional accountant in business should not be required to or expected to do so on the acts which are not related to his job's subject matter. He should be required to respond to the external auditors, only if he receives a specific inquiry on such a matter. Otherwise, it should not be obligatory for him to do so.

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?

Reply

Professional accountant must have to follow the local laws before overriding the confidentiality and disclosing the matter to appropriate Authorities. Further, as stated earlier, we believe that the professional accountant should seek proper legal advice before doing so, even if the Code provides a right to override the confidentiality instead of making it an obligation.

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?

Reply

As pointed out earlier, there is a substantial need of explaining the term 'public interest' for further clarity. A detailed guidance is required as to which suspected illegal act can affect the 'public interest', how can it affect and to what extent it can affect?

Without providing a very clear yardstick or guidance, the matter of deciding among various situations would create extreme difficulties for the professional accountants, especially in the matters of dispute.

MATTERS SPECIFIC TO PROFESSIONAL ACCOUNTANTS IN PUBLIC PRACTICE

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?

Reply

Only to the extent permitted in the Code of Ethics.

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?

Reply

As discussed in the answer to question 1, the professional accountant should be allowed to obtain legal advice from a law practitioner and, based upon such legal advice, if the professional accountant concludes that it would not be appropriate to escalate the matter to appropriate Authorities, he should be allowed to avoid it. However, if the professional accountant also concludes that such a suspected illegal act could be severe and can affect the public interest, while the legal advice does not support escalating the matter to appropriate authorities, the professional accountant may have to withdraw from the engagement.

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?

Reply

Only to the extent permitted in the Code of Ethics.

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?

Reply

Agreed. Materiality should also be considered.

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?

Reply

We would reiterate that the professional accountant should consider the prevalent laws in his jurisdiction before making such disclosure. Professional accountant may also have to seek the legal advice. In case, there is no legal bar or expected severe consequences, the 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 disclose the suspected illegal act to the entity's external auditor.

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?

Reply

Agreed only if it is genuinely a 'right' of such professional accountant and there is no threat of 'expectation for doing so' which hanging sword, in my view, nevertheless makes it an obligation instead of the 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?

Reply

Agreed.

MATTERS SPECIFIC TO PROFESSIONAL ACCOUNTANTS IN BUSINESS

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?

Reply

A professional accountant in job or business should only disclose / report the suspected illegal act to his immediate next authority as per managerial hierarchy within the organization, in case this comes under his specified official duties. However, professional accountant in business should not be required to or expected to do so on the acts which are not related to his job's subject matter.

Such a professional accountant should respond to the inquiries, if any, received from the external auditors and should not be required to report such matters at his own accord. This would be better to preserve the organizational decorum as well as his job's obligations.

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?

Reply

For a number of economic, organizational and legal justifications, a professional accountant in business should have a right to and be expected to report such suspected illegal acts only to the immediate next authority within his organization as per managerial hierarchy. However, as mentioned earlier, a professional accountant in business should not be required to or expected to do so on the acts which are not related to his job's subject matter.

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?

Reply

Agreed. However, applicable law and the materiality should also be considered for such disclosure.

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?

Reply

Agreed. However, professional accountant should be allowed to base his decision of disclosure in all cases on a specific legal advice and if such a legal advice does not provide a comfort in connection with making such a disclosure or explicitly prohibits from doing so, should also be considered as exceptional circumstances. In such circumstances, the professional accountant may have to withdraw from an engagement if he concludes that the suspected illegal act may affect the public interest materially.

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?

Reply

As stated in reply to question 14.

Question 16

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

Reply

Agreed.

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?

Reply

Notwithstanding with the above comments, we agree with the changes which are based on ED's current version. In case of changes to the ED, the changes to the Code will also need to be revised.

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?

Reply

The general comments given at outset highlight certain areas which, in our view, have not been considered. These include the legal consequences which the professional accountant must consider at his jurisdiction, the enhanced costs and efforts connected with making such disclosure, economic realities in view of global recession, expected career losses, expected impact on profession's overall image etc. In our view a more detailed impact analysis should be made and carefully considered.