

11 September 2015

Ken Siong
Acting Deputy Director
International Ethics Standards Board for Accountants
International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, New York 10017 USA

Dear Mr. Siong:

Exposure Draft – Responding to Non-Compliance with Laws and Regulations

We are pleased to comment on the proposed changes to the *IFAC Code of Ethics for Professional Accountants* (the Code) currently under exposure by the International Ethics Standards Board of Accountants (the Board) which are intended to create a framework to guide auditors, as well as other professional accountants (PAs), in deciding how best to act in the public interest when they encounter an act or suspected act of non-compliance with laws and regulations (NOCLAR).

We recognize the substantial effort that the Board has made to listen to stakeholder concerns regarding the initial Exposure Draft (ED) on this topic, *Responding to a Suspected Illegal Act* of 2012; hosting the three roundtables to solicit further views and input on these issues in 2014; and conducting additional consultations with the IESBA CAG and other stakeholders to produce a revised NOCLAR framework. We also appreciate the diligence and thoughtfulness that the Board has exhibited in these deliberations and we appreciate the Board's responsiveness to our and other stakeholders' previously expressed concerns.

The current proposed framework represents a substantial improvement from the Board's earlier proposals and we are supportive of the framework as it now stands. However, we still do have some observations and suggestions for your consideration highlighted in summary fashion below. Additional comments are also included following the Request for Specific Comments section.

- As mentioned in our response to the initial ED on this topic, we support illegal act reporting requirements for auditors providing audit services, but believe this objective is best achieved through changes to law or regulations. Accordingly, notwithstanding that we support the adoption of the new IESBA NOCLAR framework, we urge the Board to make efforts to encourage jurisdictions where no illegal act reporting requirements (and associated whistleblowing protections) exist today to adopt illegal act reporting requirements consistent with the Code.

- We note that the “reasonable and informed third party” test is included in Section 225.25 as a standard for the accountant in determining whether he/she should make a disclosure to an appropriate regulatory authority. However, in practice, we think this test will be difficult to apply since it is likely that it can only be applied in hindsight, whereas the professional accountant must make the judgment as events unfold. As the ED points out, the PA is called to make sensitive and complex evaluations in these situations and we believe PAs should be asked to simply use their professional judgment. Accordingly, we suggest this test be removed from the NOCLAR provisions in the Code.
- In our comment letter on the prior draft, we urged the Board to include some acknowledgement of the importance of accountant/client confidentiality to the profession’s ability to perform its tasks. Nowhere does the Code acknowledge that confidentiality, in and of itself, serves a valuable public purpose – one that should not be lost. Notwithstanding that the NOCLAR proposals are designed, in part, to overcome the confidentiality provisions of the Code, we believe the important role confidentiality plays in creating trust and facilitating open communication between client and PA is in the public interest should be recognized in the Code. Accordingly, we ask the Board to consider including such statement in Section 140 “Confidentiality”.

The Board has also requested comments on nine specific and three general questions and we will respond individually below.

Request for Specific Comments

General Matters

- 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?**

Yes, we believe it does, though its effect would need to be assessed on a jurisdiction by jurisdiction basis. In particular, we believe the IESBA framework should assist PAs in responding to NOCLAR in jurisdictions where the NOCLAR-related law or regulation merely contains a reporting requirement but does not include guidance to assist the PA such as is contained in the IESBA framework.

- 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?**

Yes. We believe the proposal will be helpful to PAs in fulfilling their responsibility to act in the public interest and we believe the framework, subject to our observations contained

herein, provides a reasonable basis for PAs to determine whether or not to report identified or suspected NOCLAR to an appropriate authority in the absence of a legal or regulatory requirement.

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

We believe that in many respects the expectation that the auditor respond appropriately to NOCLAR already exists and therefore the proposed framework will not represent a significant shift in the relationship between auditors and audited entities.

(b) Other PAs in public practice and their clients

We generally agree with the Board's proposals with respect to other PAs in public practice and their responsibilities regarding NOCLAR and expect that over time clients will also become accustomed to these new ethical obligations for PAs in public practice. However, we do see some practical challenges that may face PAs providing non-assurance services to non-audit clients. In particular, we are concerned that many non-assurance engagements are short in duration and the PA may only have direct interaction with a limited number of client personnel. We recognize that the Board has addressed this concern in part, in Section 225.35 which states:

*"If the professional accountant suspects that non-compliance with laws and regulations has occurred or may occur, the professional accountant shall discuss the matter with the appropriate level of management and, **if the professional accountant has access to them and where appropriate, those charged with governance.**" (emphasis added).*

However, we do not believe this concern is adequately addressed in Section 225.41 which requires the PA to consider whether further action is needed and includes a number of factors to consider in making this determination such as the appropriateness of management's response and the likelihood of substantial harm. In many instances, the PA providing non-assurance services to a non-audit client will not be in a position to assess the appropriateness of management's response to the suspected NOCLAR or the likelihood of substantial harm, particularly if the engagement is already completed. Accordingly, we suggest the board amend Section 225.41 to encourage the PA to consider whether further action is needed "when practical."

We also expect that there will be some challenges associated with PAs in public practice providing certain non-audit services when an instance of NOCLAR is the

reason for the engagement, such as fraud investigation services where confidentiality or privilege are a concern and the possibility of external disclosure may drive certain companies to seek others to provide the service who are not even subject to the IESBA Code or other professional standards and, therefore, have no explicit duty to act in the public interest. This issue, and the potential resulting shift to non-professionals, may arise in circumstances where privilege might not be established or available under local law or where confidentiality may not be mandated or contractually obligated but an expectation for such protection exists. Accordingly, we recommend that the language in the middle bullet Section 225.44 be modified to address such important circumstances. We suggest the following or similar language.

“Whether the terms or nature of the engagement, particularly in the circumstances where potential non-compliance with laws and regulations is the basis for the engagement precludes disclosure of information about the client to third parties, such as where legal privilege exists which extends to the professional accountant, or in cases where privilege might not be established or available under local law but where the engagement terms establish an obligation of confidentiality.”

(c) PAIBs and their employing organizations

The concept of whistle-blowing is not new and we don't anticipate a significant change in the relationship between PAIBs and their employing organizations. We believe the framework will be a valuable tool for PAIBs in determining how to respond to NOCLAR and may result in an increased level of engagement, but we do not see the fundamental dynamic between PAIBs and their employing organizations changing significantly.

Specific Matters

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

Yes. We agree with the objectives for all categories of PAs under the IESBA's proposed framework and believe they are appropriately differentiated and articulated.

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

Yes. We believe this represents an important clarification from the previous draft and that the more narrow focus on laws and regulations that have a nexus to the PAs professional training and expertise is appropriate.

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

Yes. We agree with the differential approach among the four categories of PAs regarding responding to identified or suspected NOCLAR.

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?

Yes, we agree with the factors to consider in determining the need for further action and believe that the threshold of “substantial harm” to be the most important. We also note that “urgency of the matter” is likely not an important factor unless combined with one of the other factors whereas each of the other factors may, on their own, be sufficient to merit further action. Accordingly, we recommend that it be deleted from this list.

(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?

As mentioned above, we believe the “reasonable and informed third party” test relative to determining the need for, and the nature and extent of further action is unnecessary and is likely to be difficult to apply. Accordingly, we suggest removal of the third party test from the framework.

(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?

Yes. We agree with the examples of possible courses of further action.

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

Yes. We agree with the list of factors to consider in determining whether to disclose the matter to an appropriate authority, except for the third party test as mentioned above in 7(b) which we believe should be removed.

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?

No. We do not agree with the approach taken in Section 225.40 which says that, if we are performing non-audit services for a client that is also an audit client of a network firm, we should “consider” informing the network firm about the illegal acts. The Board’s explanatory memorandum explains that “there may be local laws or regulations that prevent disclosure outside the jurisdiction” (paragraph 77). We believe it would be better for the standard to *require* disclosure to a network member firm in these circumstances (unless a local law prohibits that from happening). If local laws and regulations would prevent it, there is already wording that would clarify this.

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

Yes. We agree with the approach to documentation with respect to the four categories of PAs.

Request for General Comments

(a) PAIBs working in the public sector— Recognizing that many PAIBs work in the public sector, the Board invites respondents from this constituency to comment on the revised proposals and, in particular, on their applicability in a public sector environment.

We have no comment.

(b) Developing Nations—Recognizing that many developing nations have adopted or are in the process of adopting the Code, the Board invites respondents from these nations to comment on the proposals, and in particular, on any foreseeable difficulties in applying them in their environment.

We have no comment.

(c) Translations— Recognizing that many respondents may intend to translate the final pronouncement for adoption in their environments, the Board welcomes comment on potential translation issues respondents may note in reviewing the revised proposals.

We do not see any unique issues associated with translating the final pronouncement as compared to the translation of other standards or policies and we have no special concerns.

Additional Suggestions

- Section 225.44 - *Relevant factors in considering external disclosure.* includes "whether doing so would be contrary to law or regulation" as a factor to consider in determining whether to disclose outside the client for professional accountants in public practice providing professional services other than audit of financial statements. However, we believe a more emphatic statement is required and suggest the Board align Section 225.44 with Section 225.27, which provides guidance to PAs performing audits in determining whether to disclose the matter to an appropriate authority and state that "disclosure would be precluded if it would be contrary to law or regulation."
- We also highlight the following inconsistencies in the Explanatory Memorandum:

- We noted what appears to be an inaccuracy in paragraph 43 of the Explanatory Memorandum (EM). The EM contains a statement that ISA 250 requires communication with management and those charged with governance when NOCLAR is suspected to have occurred “or may occur”. This statement is only partially correct. ISA 250 only deals with NOCLAR that has occurred or is suspected to have occurred and does not deal with auditor’s responsibilities for NOCLAR that “may occur.” The ED of ISA 250 will also not add any responsibility for NOCLAR that “may occur”. We ask the Board amend this point if the topic is raised again in a future EM.
- On a related point, in paragraph 14 of the EM, it is stated that the Board believes that the auditor should have the responsibility to not only respond to NOCLAR that has occurred but also “deter the commission of NOCLAR where it has not yet occurred”, and we do not agree. Deterring NOCLAR is the responsibility of management and those charged with governance who design, implement and operate relevant controls to do so and it is important not to devolve this critical function of management.
- Paragraphs 27 and 28 in the explanatory memorandum says that the Board intends to include “insider trading” as a type of illegal act that is covered by the standard, and accordingly added “securities markets and trading” to the examples of laws and regulations that are encompassed by the standard. The explanatory standard recognizes that insider trading is a particularly complex area of the law. Indeed, in many situations insider trading is perfectly legal (which is why courts and the securities regulators generally refer to “illegal insider trading” rather than simply “insider trading”) and referencing it as an example is potentially confusing.

We would be pleased to discuss our comments with members of the International Ethics Standards Board or its staff. If you wish to do so, please contact Karen M. Golz, Global Vice Chair, Professional Practice (+1 212 773 8001) or Susan Nee (+44 20 79 8 0 08 77).

Sincerely,

Ernst + Young Global Limited

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