



American Institute of CPAs  
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September 4, 2015

International Ethics Standards Board for Accountants  
International Federation of Accountants  
529 Fifth Avenue, 6<sup>th</sup> Floor  
New York, NY 10017

Re: Exposure Draft, *Responding to Non-Compliance with Laws and Regulations*

Dear Members of the International Ethics Standards Board for Accountants:

The American Institute of Certified Public Accountants' (AICPA) Professional Ethics Executive Committee (PEEC) is pleased to submit this comment letter to the International Ethics Standards Board for Accountants (IESBA) on its Exposure Draft, *Responding to Non-Compliance with Laws and Regulations* (the "Exposure Draft"). The AICPA is the world's largest member association representing the accounting profession, with more than 412,000 members in 144 countries and a 125-year heritage of serving the public interest. AICPA members represent many areas of practice, including business and industry, public practice, government, education and consulting; membership is also available to accounting students and CPA candidates.

Throughout its history, the AICPA has been deeply committed to promoting and strengthening independence and ethics standards. Through the PEEC, the AICPA devotes significant resources to independence and ethics activities, including evaluating existing standards, proposing new standards, and interpreting and enforcing those standards. In drafting this comment letter, the PEEC has solicited input from the AICPA Business and Industry Executive Committee (BIEC) with regard to the application of proposed Section 360 to professional accountants in business (PAIB). Among other responsibilities, the BIEC is responsible for considering global issues relating to AICPA relations with its members in business and industry and identifying future trends and issues to be addressed regarding members in business and industry.

### **General Comments**

We support the IESBA's objective of setting high-quality ethics standards for professional accountants around the world and facilitating the convergence of international and national ethics standards. The AICPA has been closely monitoring the IESBA's deliberations and draft proposals regarding non-compliance with laws and regulations (NOCLAR) since its inception. We provided extensive comments to the Board's August 2012 Exposure Draft through our comment letter dated, December 15, 2012, and we actively participated at the NOCLAR Roundtable session held in Washington, DC in July 2014. We are pleased to see that many of the issues we raised in our

comment letter and at the Roundtable have been addressed by the IESBA in the revised proposals. We believe the revised proposals represent a significant improvement as compared to the August 2012 proposals and commend the Board (and its Task Force) for the significant effort it has undertaken to solicit feedback from stakeholders and revise the proposals in response to the extensive feedback received. While the proposals represent a more reasonable and workable approach to responding to a suspected or identified NOCLAR, we have provided a number of edits and recommendations in our comments below that we believe are necessary and ask the Board to consider.

#### *Disclosure to an appropriate authority*

The U.S. legal system is unique and creates challenges as it relates to confidentiality and disclosure to an external authority without appropriate state and/or federal protections. While there is no longer a requirement to disclose a NOCLAR to an appropriate authority as originally proposed, the professional accountant's judgment can still (and likely will) be challenged if, for example, the professional accountant had the ability to disclose a NOCLAR but determined not to report it to the authorities (e.g., because the professional accountant does not believe the NOCLAR would result in "substantial harm"). Specifically, if a lawsuit is later filed against the company, the professional accountant's judgments may be called into question and they may be subject to potential litigation even though the professional accountant complied with the requirements of the Code. We also are concerned that having the ability to disclose a suspected NOCLAR to an authority could result in a public expectation that such disclosure will always take place, exacerbating the "expectation gap." While we continue to have these concerns, we are pleased that the IESBA has made an effort to address these issues by adding the following as a factor to consider in determining whether to disclose the matter to an appropriate authority:

*"Whether there exists robust and credible protection from civil, criminal or professional liability or retaliation afforded by legislation or regulation, such as under whistle-blowing legislation or regulation."*

In the U.S. we believe this is an extremely important factor for the professional accountant to consider and in fact, believe such disclosure should not be made by a professional accountant unless such protection exists.

### **Responses to Request for Specific Comment**

#### *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?**

The proposals specifically state that, *"In some jurisdictions, there are legal or regulatory provisions governing how professional accountants should address non-compliance or suspected non-compliance with laws and regulations. The professional accountant shall obtain an understanding of those provisions and comply with them..."* (see *Complying with Applicable Laws and Regulations* ). Accordingly, in cases where law or regulation requires the reporting of a NOCLAR to an appropriate authority, the professional accountant would follow the jurisdictional law or regulation rather than the guidance contained within the

proposals. We therefore do not see any issue where the guidance in the proposals would hinder the implementation of any legal or regulatory requirements.

We also support the addition of the statement: “*Disclosure would be precluded if it would be contrary to law or regulation*” under the Sections, *Determining Whether to Disclose the Matter to an Appropriate Authority*. In the U.S., most states have laws and/or regulations that would prohibit the disclosure of confidential client or employer information to an authority without the client or employer’s consent unless required by law to do so. We assume similar laws or regulations exist in other jurisdictions as well. We believe this statement should be given greater emphasis within the proposed standards to prevent professional accountants from inadvertently violating their own jurisdictional laws. For example, we would recommend that the various paragraphs addressing “*Complying with Applicable Laws and Regulations*” should clarify that where jurisdictional laws or regulations prohibit the disclosure of a NOCLAR to an appropriate authority, the professional accountant should comply with the law or regulation and not disclose the NOCLAR.

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?**

In general, we do believe the proposals will be helpful to professional accountants in fulfilling their responsibilities to act in the public interest. However, see our other comments within this letter for our recommendations and proposed edits to improve the guidance.

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 support the proposed requirements applicable to auditors and agree they should have greater responsibility with regard to responding to a NOCLAR by a client than other professional accountants in public practice.

**(b) Other PAs in public practice and their clients; and**

*Forensic services*

The Board has acknowledged that it did not intend forensic-type engagements, where legal privilege exists which extends to the professional accountant, to be covered by the proposal with respect to disclosure to an authority. Paragraph 225.44 therefore includes the following factor for the professional accountant in public practice (who is not the auditor) to consider in determining whether to disclose to an authority:

*“Whether the terms or nature of the engagement precludes disclosure of information about the client to third parties, such as where legal privilege exists which extends to the professional accountant.”*

The Board, however, has concluded that forensic-type engagements that are not covered by legal privilege should be covered by the proposals and the professional accountant should have the ability to override the confidentiality principle and report to an appropriate authority under certain circumstances. We respectfully disagree with this conclusion.

Professional accountants provide forensic services, where they are retained for the purpose of investigating suspected wrongdoing, in many instances in response to the discovery of suspected fraud or illegal acts. In an investigative or litigation setting, such services may include the analysis of company books and records, data discovery and management, interviews, valuations, modeling, and expert testimony. Clients will be reluctant to hire professional accountants to provide such services, if any suspected NOCLAR that is uncovered or confirmed is subject to potential disclosure by the forensic accountants to external authorities. Instead, clients will likely turn to other service providers, not subject to the Code's requirements, who may not be as competent to provide these services. Similar considerations may also exist with respect to other types of consulting and advisory services provided by professional accountants. We believe forensic services where a client engages the professional accountant to investigate known or a suspected NOCLAR is in the public interest and should be exempt from the disclosure provisions of the proposal. Under such circumstances, the professional accountant should only be required to report their findings to management and/or those charged with governance; client management and/or those charged with governance should be responsible for taking appropriate action. We therefore ask that the IESBA reconsider its position and exempt professional accountants who are retained for the purpose of investigating suspected wrongdoing from the proposed requirements, regardless of whether or not they are under legal privilege.

*Requirements for professional accountants who only provide nonassurance services*

We agree with the Board that the extent of the required response for professional accountants in public practice who provide services other than audits should be less than that of the auditor. We believe, however, that the proposed required response for professional accountants providing only nonassurance services to a *non-audit client* of the firm may be impracticable and difficult to implement in practice. Specifically, many professional accountants who provide only nonassurance services to a client do not have access to higher levels of management or those charged with governance. The nonassurance service is often limited in duration and interaction with the client may be limited to only certain representatives of client management. The IESBA appears to acknowledge this in paragraph 225.35:

*“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)

The proposal, however, requires that the professional accountant consider whether further action is needed and provides various factors for the professional accountant to consider, such as the appropriateness of management's response and the likelihood of substantial harm. In many cases, the professional accountant will not be in a position to make a reasonable

determination on whether management took appropriate action in response to the suspected NOCLAR or the likelihood of substantial harm. Specifically, once the nonassurance services engagement is completed, the professional accountant may not have access to client management or information necessary to make that determination. Due to the limited nature of the nonassurance engagement and information available to the professional accountant, it may be impracticable to expect the professional accountant to be able to determine if further action is necessary. We believe the Board should recognize that further action may not always be practical after bringing the matter to management's attention by revising paragraph 225.41 as follows:

The professional accountant, *where practicable*, shall also consider whether further action is needed to achieve the professional accountant's objectives under this section.

#### *Disclosure to external auditor*

Paragraph 225.43 lists various actions that may be taken by the professional accountant. One such action is to disclose the matter to the external auditor if the client is not an audit client of the firm. Depending on the circumstances, such a disclosure may be in violation of jurisdictional laws or regulations. We therefore recommend that the IESBA revise this factor as follows:

Further action may include:

- If the client is not an audit client of the firm or a network firm, disclosing the matter to the external auditor, if any, *where not contrary to law or regulation*.

#### **(c) PAIBs and their employing organizations.**

##### *Addressing the Matter*

Paragraph 360.16 requires the PAIB to discuss the potential NOCLAR with certain individuals within the employing organization. Specifically, it provides that in cases where the PAIB's immediate superior appears to be involved in the matter, the PAIB must discuss the matter with the "next higher level of authority" within the employing organization. For many senior PAIBs, there may not be a "next higher level of authority" in which case it would appear appropriate to discuss the matter with the board of directors or those charged with governance. We therefore recommend this sentence be broadened to cover such bodies when no higher level of authority exists within the employing organization.

Paragraph 360.18 requires that the PAIB disclose the matter to the external auditor. In cases, however, where the matter has been rectified, remediated or mitigated after applying the steps in paragraph 360.17, we do not believe disclosure to the external auditor should be required.

In addition, in cases where the matter has not been rectified, remediated or mitigated, the PAIB should also consider disclosing the matter to the internal auditor. We do not, however, believe this should be a requirement.

Accordingly, we would recommend that paragraph 360.18 be revised as follows:

*Where the matter has not been rectified, remediated or mitigated*, the professional accountant shall also disclose the matter to the employing organization's external auditor, if any, pursuant to the professional accountant's duty or legal obligation to

provide all information necessary to enable the auditor to perform the audit. *The professional accountant may also consider disclosing the matter to the employing organization's internal auditor.*

### *Specific Matters*

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

Yes. We agree with the following objectives for all professional accountants as proposed by the IESBA:

- (a) To comply with the fundamental principles of integrity and professional behavior;
- (b) By alerting management or, where appropriate, those charged with governance of the client/employing organization, to seek to:
  - (i) Enable them to rectify, remediate or mitigate the consequences of the identified or suspected non-compliance; or
  - (ii) Deter the commission of the non-compliance where it has not yet occurred; and
- (c) To take such further action as may be needed in the public interest.

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

Yes. We agree with the following scope of laws and regulations covered by the proposals:

- (a) Laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the client's/employing organization's financial statements; and
- (b) Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the client's/employing organization's financial statements, but compliance with which may be fundamental to the operating aspects of the client's/employing organization's business, to its ability to continue its business, or to avoid material penalties.

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

Yes. We support the differential approach proposed for the four categories of professional accountants addressed in the proposals. We agree that due to the public interest role served by auditors, they should have a greater responsibility to take action in responding to identified or suspected NOCLAR by a client than other professional accountants in public practice. We further agree that senior PAIBs should have a greater responsibility to take action in responding to an identified or suspected NOCLAR than other PAIBs within the employing organization given their greater ability to influence decision-making and the expectations placed on them as a result of their position within the organization.

#### **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 proposed factors to consider in determining the need for, and the nature and extent of, further action. We also agree with the proposed threshold of credible evidence of substantial harm.

**(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?**

We agree with the inclusion of a reasonable and informed third party test for purposes of determining the nature and extent of further action needed by the professional accountant.

**(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?**

We agree with the possible courses of further action described in paragraphs 225.24, 225.43 and 360.23 of the proposals. As noted in 3(b) above under *Disclosure to external auditor*, we recommend that the IESBA indicate that the professional accountant should only disclose the matter to the external auditor where not contrary to law or regulation.

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

We support the list of proposed factors in determining whether to disclose the matter to an appropriate authority. As noted, we strongly believe that whether or not robust and credible protection from liability or retaliation afforded by legislation or regulation exists is a significant factor that the professional accountant must consider in determining whether disclosure is a viable option.

**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 agree with the proposed level of obligation in paragraph 225.40 that requires a professional accountant who is performing a non-audit service for an audit client of a network firm to consider whether to communicate the matter to the network firm. We believe the professional accountant should be able to use judgment, based on the circumstances, in determining whether the engagement partner for the audit should be notified.

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

We agree with the Board's approach to documentation. Due to the role and greater level of responsibility of the auditor, we believe a documentation requirement is appropriate. For all other professional accountants, including PAIBs, we believe encouraging documentation is an appropriate approach.

## ***Other Matters***

We offer comments on the following matters that are not specifically addressed above.

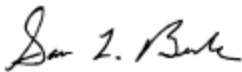
### *Suspected NOCLAR at entity other than client*

There are many engagements whereby a professional accountant in public practice is engaged by a client to perform procedures (e.g., due diligence) on a third party entity. Paragraph 36 of the Explanatory Memorandum specifically addresses such third party entities and states that the proposals are not intended to apply to circumstances where the professional accountant has no direct (e.g., contractual) relationship with the party suspected of committing the NOCLAR. Paragraph 225.8 (c) attempts to convey this point by stating that this section does not address “Non-compliance with laws and regulations committed by persons other than the client, those charged with governance, management or employees of the client. The professional accountant may nevertheless find the guidance in this section helpful in considering how to respond in these situations.”

Since it may not be clear to users of the Code that the term “client” would exclude the third party entity under such an engagement, we recommend the Board clarify that the proposals do not apply to a suspected NOCLAR at the third-party entity (i.e., even though such guidance may be helpful).

We appreciate this opportunity to comment. We would be pleased to discuss in further detail our comments and any other matters with respect to the IESBA’s Exposure Draft.

Sincerely,



Samuel L. Burke, CPA  
Chair, Professional Ethics Executive Committee

cc: Brian Caswell, CPA, IESBA Member  
Lisa Snyder, CPA, CGMA, Director – Professional Ethics