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

13 December, 2012

Re: IESBA Exposure Draft: Responding to a Suspected Illegal Act

Dear Mr Siong

Introduction

We appreciate and thank you for the opportunity to comment on the IESBA's exposure draft entitled Responding to a Suspected Illegal Act (the "Exposure Draft"). While we fully support efforts of the IESBA to strive towards enhancement of the role that professional accountants play in the capital markets, we do not believe that the proposed approach achieves that objective.

This response is submitted on behalf of the PricewaterhouseCoopers global network of firms; PricewaterhouseCoopers ("PwC") refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

Underlying the Exposure Draft is the critically important notion that suspected fraud or other illegal activity by companies and their people must be addressed by company management and those charged with governance and that the profession should play an integral role in helping to achieve this aim. PwC could not endorse that notion more strongly. While the ultimate goal of addressing illegal activity is therefore one we fully embrace, we believe that the goal is not best achieved through the proposed amendments to the Code of Ethics for Professional Accountants ("the Code"). We strongly believe that attempting to impose requirements in this important area through the Code is unworkable in important respects, would have significant negative unintended consequences for all market participants, including the profession, and would not advance the laudable goal of addressing suspected illegal activity.

Set out below is a summary of our primary concerns regarding the proposed addition of Sections 225 and 360, followed by the alternative course we believe is better suited to address suspected illegal activity and achieve the important goal of increasing the profession's sensitivity to, as well as

involvement in, helping management and those charged with governance in addressing such activity. We expand on our reasons in attachment 1 that follows.

Summary of our primary concerns

Our concerns about the proposals fall into two general categories. First, we believe the proposals are too complex, create uncertainty about how the requirements will be met in practice, cannot provide protection to the professional accountant and therefore are unworkable. Second, we believe that the proposal will not enhance, but rather will be detrimental to, the strength and credibility of the accounting profession, the audit function, and ultimately to the capital markets. We summarize the basis for these concerns below.

1. **The proposals are overly complex, lack clarity, cannot provide protection to the professional accountant and therefore are unworkable.**

   1.1 A professional code of ethics is not the right place to include such mandatory requirements, particularly as regards breaching client confidentiality and external reporting. The proposals do not and cannot include any whistleblower protection and therefore risk subjecting professional accountants to untenable personal and firm risk for both reporting and failing to report to an appropriate authority. The potential harm to companies, their people, and their shareholders from a professional accountant reporting suspected illegal activity either prematurely or, in hindsight, on an inadequate basis presents significant but unwarranted potential exposure to all accounting firms and professional accountants, whether in professional practice or in industry.

   1.2 The proposed threshold for reporting to an appropriate authority "suspected illegal acts of such consequence that disclosure…would be in the public interest" is too broad, too vague, and too susceptible of a wide range of interpretations to make it workable. Rather than giving the professional accountant leeway in deciding what to report, the proposed standard instead could lead to different accountants making very different judgments, not only potentially opening the door to significant liability but also importantly creating uncertainty and fundamental unfairness to companies and their shareholders resulting from the potential for different results for different companies with different accountants but based on similar facts and circumstances.

   1.3 Other standards for conduct in the proposal are equally impracticable. For example, the level of suspicion trigger is confusing. At what point a professional accountant must take reasonable steps to confirm or dispel suspected illegal activity is undefined and not specified. Nor is any guidance provided as to what is appropriate evidence to confirm or dispel the suspicion of illegal activity.

1.4 The proposals would broaden, unreasonably in our view, the auditor's responsibilities far beyond applicable auditing standards by requiring professional accountants who are auditors to investigate any suspected illegal act of which they become aware (i) through the performance of the audit, (ii) through disclosure by a professional accountant employed by their audit client or (iii) from anyone in a professional accounting firm performing non-audit services for the entity. This is unlike Section 10A of the US Securities and Exchange Act of 1934 ("Section 10A"), for example, which limits the auditor's responsibility to information arising from the audit. Beyond broadening the auditor's audit responsibilities, the proposal would also increase the expectation gap about the role of the auditor, and undoubtedly and perhaps significantly expand costs because of the investigatory work that would necessarily be required. The scope of the proposals are overly broad for the additional reason that, by requiring professional accountants to investigate and escalate all suspected illegal acts, without regard to significance or materiality or relevance to the service being performed, they risk significant time and costs being expended in investigating suspicions that may prove to be trivial or inconsequential in nature. We also note that, again unlike US Section 10A, this proposal applies both to public and private companies, thereby further compounding these issues.

1.5 Potential conflicting responsibilities are not wholly resolved by the current Code's provision in its preface (and paragraph 140.7) that local law and regulation prevail where the provisions in the Code conflict. It must be recognized that what is a conflict is not a clear or easy determination in most instances and puts professional accountants in a continuous conundrum of deciding when there is a potential conflict and if so what obligations prevail. Professional accountants should be well aware of the importance of their obligations to comply with their own laws and regulations with respect to suspected illegal acts. Imposing on accountants different obligations through a cross-border Code potentially compromises their ability to comply with their existing and often complex local obligations. The proposals are certainly unclear on this how this dilemma should be managed.

1.6 The proposals disrupt and potentially override the careful balance struck in national regulations and legislation in this area, which have been enacted after weighing the benefits of professional obligations of confidentiality and who should be responsible for reporting potential illegal activity in those jurisdictions. This is a matter for governments and regulators, not professional ethics standards. Moreover, if not all IFAC Member Bodies adopt the proposals, not only will professional accountants have a virtually impossible task of deciding what to do where, it will undoubtedly also harm the overarching goals of convergence and closing the expectation gap.

1.7 The documentation provisions are unduly onerous and create unwarranted and unfair risks for companies and their shareholders. The extensive documentation

required — persons consulted, responses received, etc. — could seriously undermine the company's ability to obtain the protection of privileges, such as the attorney client and work product privileges, to which they would be otherwise entitled.

2. The proposals are detrimental to the strength and credibility of the accounting profession, the audit, and ultimately to the capital markets.

2.1 Without a promise of confidentiality, and very clear and unambiguous exceptions that all market participants understand, the effectiveness of what auditors and accountants do is put at serious risk. Confidentiality is one of the bedrocks of the accounting profession. Such a wholesale override of this foundational principle on which the profession is based would undoubtedly have a chilling effect on the essential free flow of information between the company and its auditors which ultimately will hinder, not enhance, the audit process as a whole as well as the ability to identify and respond appropriately to potential illegal activity.

2.2 The proposals would fundamentally and inappropriately alter the role of the auditor by requiring the auditor to investigate (as opposed to escalate to appropriate levels) matters unrelated to the audit brought to their attention by those performing totally unrelated non-audit services or who work for the company inside and outside of financial reporting areas - and to which International Auditing Standards do not apply. (It should be noted that having auditors be the recipient of complaints and part of a company's internal whistle blowing procedures could be seen to compromise independence by making the auditors part of the system of internal controls, which is of course a management responsibility.) Such a requirement also risks significantly disrupting the timeliness of financial reporting to the public, as well as a company's own governance - potentially adding significant costs to shareholders of public companies and owners of private ones.

2.3 The proposals have the potential for creating significant harm to companies and their shareholders by accelerating reporting of suspicions to authorities, and triggering potentially harmful disclosures and consequences, which may turn out in the end to be entirely without merit. Litigious environments further compound the potential for unwarranted harm.

2.4 The proposals could perversely undermine IESBA's goal of addressing illegal acts because they discourage companies from hiring those non-audit professionals who may have the most skill and are most expert in finding them. For example, it would not be surprising if good ethical companies decide that it is prudent not to hire accounting firms to perform forensics investigatory work because of the additional obligations that would be imposed on those firms that would not be imposed on others and the operational uncertainties created by this proposal. Thus, the proposals have the potential to deprive companies of the benefits of accountants'

services even when accountants are the best qualified. And if not engaged, the requirements obviously will not be applied. Even if professional accountants were engaged and the proposal did apply, the inability to promise confidentiality could impede the free flow of information and therefore the effectiveness of their work. Either way, IESBA's goals will be undermined.

2.5 The Code cannot provide any protection to the individual accountant and thus the proposals create real risks for individuals. This in turn can result in firms having difficulties in hiring and retaining the best people, including audit personnel at a time when the importance of the audit continues to increase and there is a greater focus on audit quality.

In addition, we note that the desire to extend obligations on all professional accountants appears to have overtaken the original remit for guidance on this subject. As originally conceived, as we understand it, the project's focus was on providing guidance, not prescribing reporting rules. This is consistent with our related response to the Board's Work Plan and Strategy for 2010-12. Moreover, in extending these provisions to all professional accountants (whether in government, as regulators, in business as well as in public accounting) and going well beyond the provision of guidance, the project has serious and negative implications far beyond what we understand was intended. Guidance means advice and help, not mandatory directives. Rather than providing practical guidance to professional accountants on how best to respond to the discovery of suspected illegal activity within the confines of accountants' contractual, legal and regulatory obligations, this proposal mandates much more - certain investigative steps, the evaluation of public interest and ultimately disclosure potentially either in violation of or inconsistent with professional standards and contractual and existing legal obligations. It does so entirely divorced from parallel obligations on companies, obligations already imposed on independent accountants by national laws and regulations, and without the legal protections that typically go hand-in hand with mandated breaches of important contractual and professional obligations.

Responses to supplementary questions

We have not explicitly addressed the supplementary questions that the Board has raised in the Exposure Draft given our overall view of the proposal and because we do not believe that the questions address the core issues, though our responses do implicitly address the questions. If, however, the Board is, in its analysis of responses, assessing numerical support for the proposals implied in each question, we note that we would not support any of the proposals other than in principle (if the proposals were to proceed) questions 14 and 15 which relate to the exceptional circumstances in which the professional accountant is not required to disclose a matter externally (provided the provision was suitably amended). In particular, we note:

(a) We believe that the "exceptional circumstances" provision is too vague and narrow to provide adequate protection. We would strongly support an expanded provision with

the exceptional circumstances carve-out more particularly defined and expanded to include, for example, where the accountant is at risk of exposure to legal liability or where there is a lack of adequate legal whistle-blower protection.

(b) Our view of the proposals would not be ameliorated by amending the proposed Code so that it merely enacted a "right which the accountant is expected to exercise" as opposed to a "requirement." While to be sure there is a conceptual difference between a "right" and a "requirement", in this context characterizing the Code as simply creating a "right" and not a "requirement" would, we think, exacerbate the problems we have identified. A "right" creates additional ambiguity and introduces the concept of discretion which in practice would cause more uncertainty and render the provision even more difficult to apply. Without any clear standards as to how a professional accountant should exercise his or her discretion, a discretionary right would either render the provision meaningless or open up every decision to second guessing, making the decision even more difficult to defend. Moreover, we do not believe the Code can give a professional accountant a unilateral "right" to breach statutory, regulatory or contractual obligations including duties to protect confidentiality. At most the Code could provide that where the law or contractual obligations do not preclude reporting (140.7), an accountant's report to an appropriate authority would not be a breach of the Code and would thus not be a disciplinary matter or otherwise need to be dealt with under the planned provisions on breaches of the Code.

(c) We support the principles behind the proposed changes to Sections 210 and 300, although we suggest that certain wording changes as set forth in attachment 2 are appropriate.

An alternative approach: what we support

PwC supports professional standards and national legislation/regulation requiring auditors and other accountants (and indeed other professions such as lawyers and bankers) to bring suspicions of illegal acts, within their area of expertise, to client management and, where appropriate, those charged with governance. The Code could help guide professional accountants as to what not to do in the face of information of suspected illegal activity. For example, the Code could contain a set of principles, consistent with professional standards, that a professional accountant cannot assist the client in carrying out illegal acts, cannot turn a blind eye to suspected illegal activity and should consider if and how the matter should be reported to client personnel and those charged with governance.

We also support compliance with law or regulation requiring disclosure by auditors (or others) of specified matters to an appropriate authority, provided there is proper protection, sufficiently specific triggers for reporting, and the matter is within the competence of the accountant. As

evident by Section 10A in the United States[1], and by legislation in, for example, France and South Africa[2], proper protection can only be provided by regulation or law and entails anonymity for the whistle-blower, criminal, legal and professional liability protection for *bona fide* reporting, and legal safeguards to ensure fair outcomes for the accused. We note that the Organisation for Economic Co-operation and Development recommended in 2009 in its recommendation on anti-bribery measures that the member countries, in developing appropriate laws and regulations on auditors reporting such matters, ensure that those reporting reasonably and in good faith are protected from legal action.

Any external reporting responsibility should rest primarily with management and those charged with governance. If an auditor suspects management fraud, auditing standards require a report to those charged with governance and responsibility for further action rests with them. If the company's actions are considered inadequate, the external auditor's role is, depending upon the facts and circumstances, to report to the company's Board and then to the market either by qualifying the audit report, disclaiming an opinion, or resigning. Only national legislators are in a position to determine the appropriate and delicate balance between the long term benefits of confidentiality and professional obligations to the effectiveness of the accounting profession and who, in the larger scheme of things, should be responsible for reporting suspected illegal activity and in what circumstances.

Conclusion

Given the importance of this topic, we urge the Board to carefully consider the feedback from all respondents and to consider holding hearings and roundtable discussions about other ways, including the adoption of relevant guidance, by which these goals might be achieved. We do not believe this proposal should proceed in its current form and we recommend that the Board effectively treat this as an initial consultation and be prepared to re-expose any further proposals in this area.

In addition, given that a key issue is the role of auditors with respect to suspected illegal activity, we also encourage the Board to fully involve the International Auditing and Assurance Standards

[1] Section 10A of the US Securities and Exchange Act of 1934 requires the auditor to notify the Board (of a company) of any unremediated illegal acts which came to the auditor's attention during the audit which would have a material effect on the company's financial statements. If the Board does not take appropriate remedial action with respect to those material illegal acts, the auditor advises the company and provides the same notification submitted to the Board to the SEC to the extent the Board itself refuses to notify the SEC. The Act contains whistle blowing protection for the reporting accountant.

[2] France Law 2007-1598 on the Fight against Corruption; Protected Disclosures Act 26, South Africa

Board in future deliberations on this topic. We also encourage the Board to work with those within IFAC involved in developing any further guidance on the meaning of the "public interest".

We believe that the Board should also undertake an analysis of the legal implications and potential conflicts with existing laws and regulations, including researching jurisdictional experiences with existing legal whistle-blowing schemes (e.g. in the USA, France, Australia and Belgium). We would be happy to assist in performing that analysis.

If you would like to discuss any of the points raised in this letter, please contact Ian Dilks. Telephone: +44(0)20 7212 4658; email: ian.e.dilks@uk.pwc.com.

Yours faithfully,

Ian Dilks
Global leader, Public Policy and Regulatory Affairs

ATTACHMENT 1: ADDITIONAL DETAIL AND COMMENTS.

A. The proposals are overly complex, lack clarity, cannot provide protection to the professional accountant and are therefore unworkable.

1. Whistleblower reporting obligations are not appropriate for a Code of Ethics. *[Primary concern 1.1]*

Fundamentally, a professional code of ethics, like the IESBA's, is not the right place to include such mandatory requirements, particularly as regards breaching client confidentiality and external reporting--especially since the Code cannot provide any concurrent legal protection to professional accountants. Any such requirements and obligations should be in jurisdictional law or regulation where such protection (e.g., from litigation) can be provided. A code of ethics governs and guides personal behaviour. It is not a place to set requirements that have a potential for significant impact not only on the legal rights and obligations of clients (and employers) as well as of professional accountants but also on the conduct of client engagements and, where relevant, audit quality.

Most jurisdictional ethical codes in the profession have a clear prohibition against accountants disclosing confidential client or employer information. A Code provision that would cause accountants to breach compliance with confidentiality obligations, an important hallmark of the profession, whether because of a requirement or a right, would present accountants, regulators, and standard-setters in those jurisdictions with a difficult and not easy to resolve dilemma. While the Board may expect that changes to the Code will simply be incorporated into local ethics codes, we do not believe it would be that simple.

2. The proposed standards for reporting are too broad and too ambiguous for consistent application. *[Primary concern 1.2 and 1.3]*

<u>The "Public Interest"</u>

The proposal requires the auditor (and other accountants in public practice and in business) to make subjective judgments about whether a suspected illegal act is of such consequence that disclosure to an appropriate authority would be "in" the public interest. As evident from the IFAC's own definition[3] of the "public interest" issued in June 2012, a broad public interest standard is not only difficult to understand but also, in this context, is far too broad to be capable of consistent application. This difficulty is exacerbated by the proposal's apparent rejection, in the case of auditors, of any consideration of the significance or materiality of the act to financial reporting in the public interest determination.

[3] IFAC Policy Position 5 defines the public interest as: "The net benefits for, and procedural rigor employed on behalf of, all society in relation to any action, decision or policy."

Making these kinds of broad judgments about the public interest is not generally consistent with the obligations of auditors. For example, the auditing literature guides an auditor about how to respond to an error, whether unintentional or intentional. If the error may be intentional, the guidance also lays out the evidence that the company and then the auditor will need to muster in order to determine the impact on the financial statements and disclosures. There is no framework or standard for requiring an auditor to investigate and potentially report externally with information well outside the scope of its responsibilities. If there are suspected illegal acts to be reported, those charged with governance should be the ones charged with addressing it. The problem is most stark in connection with the proposal's treatment of accountants who perform non-audit services and accountants in business. Although auditing standards guide auditors as to how to plan and design audit procedures to detect potential illegal acts that may affect the financial statements and how to respond more generally to information suggesting a potential illegal act may have occurred – such that auditors have both learning and practical experience in this regard – accountants who are not auditors (and indeed non-accountants in a firm) have no similar guidance or experience. In fact, even local law, like Section 10A, limits its applicability to potential illegal acts discovered "during the audit."

The "level of suspicion" trigger

This standard in the proposal is also confusing. The professional accountant is required to take reasonable steps to confirm or dispel the suspicion that an illegal act has occurred and would therefore require communication to management. By escalating the matter, according to the Exposure Draft, the professional accountant "would obtain additional information about the suspected illegal act" and thus, before reaching the stage where external disclosure is required, would be "able to reach a reasonable level of suspicion." In essence, the proposal requires the professional accountant to take steps to confirm or dispel suspected illegal activity before the professional accountant has even reached a reasonable level of suspicion that there is any suspected illegal activity. As a practical matter, at what point a professional accountant must take reasonable steps to confirm or dispel suspected illegal activity is undefined and not specified, but it is clearly before the professional accountant has reached a reasonable level of suspicion.

Moreover, the Exposure Draft provides no guidance as to what is appropriate evidence to dispel or confirm the suspicion of illegal activity. Is a representation from management sufficient to dispel a suspicion; does the professional accountant have to corroborate information by interviewing relevant witnesses; does the professional accountant have to look at documents, conduct email searches; does he or she have to consult with a lawyer as to what is legal or illegal or at least gain an understanding of the potential laws implicated or potentially implicated by certain conduct? Does the professional accountant need to assess the potential applicability of safe harbors protecting certain conduct from being viewed as illegal? Would not that be a reasonable step to take to dispel or confirm suspicion of potential illegal activity? But how should the professional accountant go about doing that? The fact that these obligations apply to accounting firms and individuals within them magnifies the problem. Does each professional accountant or employee of an accounting firm have to undertake steps sufficient to dispel or confirm the suspicion and what happens if

individuals then come up with different answers? And who is going to pay for all of this additional, potentially significant, work?

Standard for reporting

There are further issues about the matters to which the proposal applies. In particular, the proposed requirement for audit clients relates to matters that directly or indirectly impact the client's financial reporting. There is no discussion of the meaning of "indirectly". Whether an act (such as the impact of cartels) can indirectly impact financial reporting is clearly open to interpretation and in some significant cases the impact on reporting may not be known until much later in legal proceedings. This makes compliance with the Code difficult and perilous for the professional accountant.

3. The scope of matters requiring investigation and escalation is not appropriate. ***[Primary concern 1.4]***

The proposal addresses "any" suspected illegal act in terms of a requirement to investigate and escalate the matter. Even though the proposal indicates that the accountant "is not expected to have detailed knowledge of laws and regulations beyond that which is required for the service," some level of knowledge would be required or at least the accountant would be required to seek legal advice (at cost) potentially with respect to matters that are not within the accountant's professional purview. For example, in the course of providing services an accountant comes across evidence that suggests that a client employee is downloading copyrighted material from the internet. This may well be an illegal act, but is it really appropriate to require the professional accountant to seek advice, investigate and escalate? We believe not. If there is to be guidance on matters which an accountant is required to respond to, we believe this should be limited to that within their expertise and which is relevant to the service being provided.

Such a situation would equally strain relationships between colleagues if an accountant in business suspects a colleague of such an act and places the accountant in an invidious position.

The proposals have no regard to significance or materiality and would require a professional accountant to investigate, also at a cost, what might be very minor matters. The proposals do not focus attention on investigating matters which would be of significance to the public or those with oversight responsibilities for the capital markets.

We also have concerns about an implicit requirement (before the accountant decides whether these Sections of the Code apply) to determine whether conduct was unethical or improper as opposed to potentially illegal; this is fraught with difficulty and if, with hindsight, the professional accountant came to the wrong decision, he or she would be in breach of the Code and therefore, absent protection, potentially subject to liability.

Furthermore, while the proposals says that a professional accountant should comply, when considering disclosure, with any legal requirements against "tipping off", the required initial

investigations and escalation themselves could result in tipping off and thus make compliance with the proposals impracticable.

4. The proposal has the potential to conflict with existing obligations. *[Primary concern 1.5]*

The vast majority of countries already have laws, regulations and/or professional standards governing an auditor's obligations with respect to suspected illegal acts. The auditor's responsibility is to comply with those laws, regulations and standards, a fact that is recognized, for example, in how auditors are required to respond to suspected fraud and illegal acts in ISAs 240 and 250 respectively. Compliance with local laws regarding when and how a professional accountant in practice may or must report suspected illegal activity internally within its client's operations and then externally is not optional. To a much lesser extent local laws and regulations govern the obligations of other professional accountants. Imposing on accountants different, even if not expressly conflicting, obligations in this area through a jurisdictionally cross-cutting Code thus potentially compromises the ability of professional accountants to comply with their existing, and often complex, local legal obligations.

While the proposal indicates that a professional accountant should consider any applicable legal or regulatory requirements and comply with such requirements and not disclose if specifically prohibited by law (para 140.7), that limitation is potentially unclear and does not give sufficient guidance to professional accountants as to how to navigate what would often be conflicting requirements regarding the investigation and reporting of suspected illegal activity. For example, under Section 10A of the Securities and Exchange Act, duly enacted legislation in the United States imposes upon auditors certain obligations (and provides related protections) if they learn *during the course of an audit* that an illegal act may have occurred. Ultimately, no external reporting obligation is triggered if appropriate remedial steps are taken by the issuer to address the illegal act in the context of the issuer's financial reporting obligations.

Notwithstanding the action taken by the entity, under this current proposal, it is unclear whether an auditor in the United States would nonetheless be required to undertake, outside the protections afforded by Section 10A, an independent "public interest" determination to determine whether disclosure of the suspected illegal activity to an appropriate regulatory authority (by the entity or the professional accountant) is nevertheless warranted. Despite the preface to the Code, it is unclear whether compliance with Section 10A (i.e., disclosure to regulators should not be made because the auditor is satisfied with the remediation) absolves the auditor of the requirement under the proposals to undertake the public interest evaluation. The distinction in this context between (1) a conflict with applicable legal and regulatory requirements and (2) an additional requirement over and above what is required under applicable legal and regulatory requirements, such as Section 10A, is, we believe, unavoidably ambiguous and therefore fraught with peril. There are similar analogies to various "illegal act" provisions in other jurisdictions. It potentially leaves the professional accountant to grapple with the choice of which laws/contractual obligations to breach and to guess as to how a court of law would interpret the course of action pursued.

The proposal has the potential to cut across existing obligations and require clients to make

disclosures they otherwise perhaps wouldn't - thereby, through a code of ethics, legislating a client's disclosure obligations by substituting a professional accountant's judgment as to when and what to disclose for the company's own determination. This is not appropriate.

If the Board proceeds with the proposal, as noted above, we believe that it at the very least should be expanded so that: (i) the public interest determination and external reporting requirement need not be undertaken by the professional accountant if the reporting requirement under applicable law, regulation or standards in the local jurisdiction is otherwise met, even if less onerous; and (ii) the circumstances in which the accountant is not required to disclose includes those where the accountant is at risk of significant exposure to legal liability and/or where there is a lack of adequate whistle-blower protection in the jurisdictional law or regulation. As is evident from our other comments, however, this would not in our view is be sufficient to address all of our concerns with this proposal.

5. The balance between competing interests should be struck by legislators, not Codes of Ethics. ***[Primary concern 1.6]***

Professional accountants should not be required to substitute their personal views of the public interest for the views of duly elected legislators and regulators whose public interest determination is reflected in the careful balance struck in the laws and regulations they have enacted. The balance struck in the legislation and regulations in this area reflects a broad view of the public interest – one that takes into account the longer term balancing of the benefits of confidentiality and professional obligations and the addressing of suspected illegal activity and who should be primarily responsible for reporting it. It is not appropriate for the Code to require professional accountants on a case-by-case basis to second guess that balance by forcing them with respect to every suspected illegal act to make an individual public interest determination regarding whether disclosure (either by the entity or the accountant) of that one act is at a moment in time in the public interest. Not only does the requirement embody an overly narrow view of the public interest by effectively ignoring the longer term interests implicated by disclosures over time, but it foists professional accountants individually into the role of the decider of what is in the public interest. And then the proposal seeks to impose the consequences of that individual's view on others. As noted in paragraph 2 above IFAC's own recently issued definition of the public interest, which presumably would be deemed to guide interpretation of an IESBA Code which required public interest to be considered, is too broadly worded to be of assistance.

6. The documentation requirements are unduly onerous and potentially unfair. ***[Primary concern 1.7]***

The documentation requirements are very onerous and would be extremely damaging to professional accountants' relationships with their clients. Under the proposal, the professional accountant must document all persons consulted, responses received and the disclosures made, without regard to significance/materiality. The example given in the Explanatory Memo is that of

pilferage in a retail store (and it is not clear if this is limited to staff or includes customers). This documentation is the responsibility of management, not the auditor or other accountant. In addition, documentation would be required with respect to a determination that external reporting was not required due to exceptional circumstances. In the context of suspected illegal activity, these documentation requirements could seriously undermine applicable privileges, such as the attorney-client and work product privileges. This sort of documentation, which is afforded no protection from discovery, will potentially expose the clients of professional accountants to a myriad of privilege waiver arguments.

This documentation requirement will exacerbate the chilling effect of the proposal on the willingness of companies both to engage professional accountants and to exchange information with professional accountants freely.

We believe that the documentation for professional accountants in business is unrealistic.

B. The proposals are detrimental to the strength and credibility of the accounting profession, the audit, and ultimately to the capital markets.

1. The proposals would chill the free flow of information. Requiring accountants to breach ethical obligations of confidentiality and contractual obligations is not appropriate. *[Primary concern 2.1]*

The proposals would potentially have a significant chilling effect on the free flow of information between professional accountants and their clients (and potentially employers in the case of those in business). That is because the proposed provisions impose additional external reporting obligations on professional accountants in public practice. Those obligations fundamentally alter existing confidentiality requirements, a foundational principle on which the profession is based.

In the context of an external audit, confidentiality creates an environment where management can freely discuss all aspects of the business with the auditor. Confidentiality understandings are, therefore, an important underlying contributor to the efficacy of the audit and audit quality. It is for these reasons that the Code includes confidentiality among the fundamental principles with which accountants are required to comply. Proposals to impose external reporting obligations over and above those set out in professional standards and the law, and particularly obligations that flow from potentially multiple individual and separate (and therefore unpredictable) determinations of "public interest," will negatively impact the open communications required between management and the auditor to perform an effective audit. It is the free flow of information, the access of the auditors to the client's personnel, and the client's information that is critically important to addressing suspected illegal activity. Chilling that free flow in any way by making clients' management less willing to give professional accountants access, and perhaps engaging those not subject to these obligations, is thus entirely counterproductive to IESBA's goals, as well as the goals of and balances already struck by national regulators and legislators.

This chilling effect is not restricted to the auditor but may well impact communications with other professional accountants. Any such impact is likely to be detrimental to the interests of the company and ultimately is not in what we consider most people would regard as the public interest.

In addition, professional accountants in public practice agree terms of business and contractual obligations, including important obligations regarding confidentiality, governing services to be provided. Disclosure of a matter outside the entity would generally be a breach of those obligations and we do not believe that a Code of Ethics can require an accountant to breach those requirements, most certainly in the case of services to non-audit clients. At the very least firms would need to allow for the possibility of having to disclose a matter in their terms of business – we believe it would be difficult to agree contractual terms along these lines, particularly for consultancy type engagements, and that this would exacerbate the competitive disadvantage that accountants would be placed at.

Accountants would potentially have to choose between violating law/contractual obligations or their professional standards. Professional standards are incorporated into the contract between a public practice firm and its client, so a failure to adhere to the Code could be considered a breach of contract as well; it is unclear how a court of law would rule in deciding the breach of contract/law claims.

Clearly there would be similar difficulties for professional accountants in business who might be required to breach their employment contracts (given that the exception clause does not allow them to take into account the subsequent threat to their employment status or risk of litigation).

2. The proposals would have a negative impact on the already complex role of the auditor. *[Primary concern 1.4 and 2.2]*

The proposal would undoubtedly have a negative impact on the role of the auditor and would fundamentally, and inappropriately, change the role of the auditor. It would make the auditor an arm of the "government" (in the broadest sense) and put the auditor in an adversarial position with the management and/or those charged with governance of the audit client. Not only would this further chill communications but it could potentially impair the auditor's independence.
This goes beyond the threat that the auditor will report to regulators or other authority its own view of information communicated by the management of the client entity. Once a suspected illegal act is reported, it is likely that the auditor will be required to cooperate with the relevant authorities in investigating and possibly pursuing the complaint – potentially making the auditor an adverse witness in both preliminary and trial proceedings. There are also other unintended consequences to this proposal. For example, will disclosure at a preliminary stage have to be made, causing the company and its shareholders unnecessary and potentially irreparable harm?

In addition, by bringing to the auditor's attention information about suspected illegal acts, of any type, from other accountants who provide other unrelated services to the company (including those accountants employed by the company and perhaps even governmental officials) and requiring the auditor to then investigate and make judgments about the other accountants' information, not only

blurs the important lines about what the auditor is auditing but also puts the auditor in a fundamentally unfair position about being the "watchdog" over potentially all aspects of a company's business – whether within the auditor's role and responsibilities or not. It unreasonably extends the auditor's responsibility from what is revealed by the audit process to what is revealed by an accountant outside the firm, at any time and no matter the subject matter. Responsibility for pursuing the matter, once the auditor has been advised, is unclear and fraught with ambiguity and potential for either duplication or matters "falling through a gap." It is also likely to exacerbate the expectation gap that is often mentioned. Further, there is also a cost that would be incurred by the auditor and it is by no means clear who would be responsible for that.

For accountants within a company and those providing services to a non-audit client, the appropriate notifications should be only through the company's own governance, including, for example, its whistleblower hotlines.

3. Accountants will be put at a competitive disadvantage and companies may feel restricted in their choice of advisors and employees. ***[Primary concern 2.4 and 2.5]***

The extension of these provisions to professional accountants performing non-audit services would have an effect on the willingness of companies (or individuals) to engage professional accountants for non-audit services. For example, in the tax area where professional accountants compete with non-accountants, such as lawyers, these proposals would create a powerful disincentive for companies to hire professional accountants. If a company hires a firm of accountants to do non-audit work, this additional responsibility would be imposed on them. If the company hires others, like non-certified/chartered consultants, there will typically be no such obligation. A similar impact would be felt in other areas, such as forensic investigation and IT system implementation projects (which often have little to do with accounting expertise). Putting accountants at a competitive disadvantage because of a threat of reporting to others is not in what we regard as the public interest. In addition, as a result of this, companies would effectively be denied the ability to choose advisors and may well be deprived the proper right to engage counsel and invoke, where appropriate, the attorney client privilege. The competitive impact is further exacerbated because the provisions appear to apply to non-accountants employed by public accounting firms. We believe that this could create great difficulties for companies as they choose who to hire to provide services, not because of a desire to hide matters that they are otherwise required to disclose but because of the uncertainties described above as to how and when the public interest should be considered to create a reporting obligation.

There may be similar unintended consequences for the relationships between accountants in business and their employers.

As noted above, the Code cannot provide any protection for individual accountants and the responsibilities imposed through this proposal could often place an individual in an invidious position compared to similar people who are not employed in public practice. We fear that this would make it more difficult for firms to hire and retain the best people (including non-

accountants) who are necessary to allow auditors and others to fulfil their public interest responsibilities.

ATTACHMENT 2 – SECTIONS 210 AND 300

As part of IESBA's assessment as to the best way to proceed we recommend that the following changes should be made to Sections 210 and 300.

We believe that the last paragraph of Section 210.5 should be amended by adding the bolded language as follows: "Where it is not possible to reduce the threat to an acceptable level, the professional accountant in public practice shall **consider termination** of the client relationship." Termination of current contractual obligations involve serious considerations of potential legal, regulatory and reputational risks and harm both to the professional accountant , the company and its shareholders, and therefore we do not believe that it is appropriate for the code to mandate termination of the contractual relationship.

We do not understand the additional language "Examples include improper earnings management or balance sheet valuations" in Section 300.6 and strongly suggest it be deleted. These random examples are neither informative nor necessary to make or amplify this requirement.

With respect to Section 300.15, we do not believe that it is appropriate to suggest that professional accountants consult with professional bodies on an "anonymous basis". Anonymity cannot relieve the accountant of confidentiality obligations. We suggest that the provision be limited to obtaining legal advice, where confidentiality would be maintained.