



International Ethics Standards Board for Accountants
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Dear Sir/Madam

RE: Exposure Draft, Responding to a Suspected Illegal Act

On behalf of RSM International Limited, a global network of independent accounting and consulting firms, we are pleased to have the opportunity to respond to the International Ethics Standards Board for Accountants' (IESBA) Exposure Draft, *Responding to a Suspected Illegal Act*.

Among other matters, the IESBA Exposure Draft addresses circumstances where a professional accountant is required to override the fundamental principle of confidentiality and disclose a suspected illegal act to an appropriate authority. We believe it is in the public's interest for the professional accountant to report suspected illegal acts to the appropriate levels of management of a client, and to those charged with governance if management's response is not appropriate and timely.

However, for the reasons stated below we do not agree that a professional accountant should be required to disclose suspected illegal acts to an appropriate authority in the manner dictated by paragraph 225.13 of the Exposure Draft.

"Prosecutorial" Role

The quality of an audit is based on the integrity, competence, objectivity, and independence of the professional accountant. An auditor must be without bias with respect to the audit client otherwise the auditor would lack the impartiality necessary for the dependability of the audit findings. However, independence does not imply that the auditor would have the attitude of a prosecutor, but rather a judicial impartiality that recognizes an obligation for fairness not only to management and owners of a business but also to creditors and those who may otherwise rely (in part, at least) upon the independent auditor's report, as in the case of prospective owners or creditors. Being independent with respect to an audit client, therefore, should not place the professional accountant in the role of a prosecutor. Requiring the professional accountant to disclose suspected illegal acts to the appropriate authority would, in reality, put the professional accountant in a "prosecutorial" role and may make the client more inclined to withhold information from, or be less forthcoming with, the accountant.

Safe Harbor

Although professional accountants are informed in a general manner about matters of commercial law, they are not legal experts, and thus, may face increased exposure to litigation when potentially incorrectly disclosing a suspected illegal act. Any requirement to disclose a suspected illegal act should be accompanied by regulations that afford safe harbor "whistle-blower" protection for the professional accountant who makes such disclosures in good faith. Such protective mechanisms can only be established by law, and it is not possible for the IESBA to establish protective mechanisms for professional accountants who have to comply with the Code. It is disproportionate to establish a requirement to disclose without providing those who would be required to make the disclosures with any protective mechanisms.

Confirming or Dispelling Suspicion

Per paragraph 225.5 of the Exposure Draft, if a professional accountant in public practice providing professional services to an audit client of the firm or network firm acquires, or receives, information that leads the accountant to suspect that an illegal act has been committed by the audit client, or by those charged with governance, management or employees of the audit client, the accountant must take reasonable steps to confirm or dispel that suspicion. In doing so, the professional accountant may not have access to all the information needed to be able to confirm or dispel the suspicion that an illegal act was committed, and this may lead to an increase in disclosures of an erroneous nature. On the other hand, if the professional accountant goes on to make further enquiries of those suspected of an illegal act, this may have the effect of “tipping off” those involved in criminal activity, which could have a detrimental effect on future investigations by the appropriate authorities.

Disclosure in the Public Interest

We believe that what is deemed to be in the public interest will vary from person to person, and it is unclear how the determination that a matter is in the public interest should be made, as required by paragraph 225.10. The subjective judgment required to make this determination could result in a wide range of conclusions and produce inconsistent results.

The concept of consideration of the public interest is a complex concept and one that is undefined in the Code. Accountants are more familiar with the concept of materiality, so disclosing matters that have a material effect on the financial statements may be a more concrete threshold for disclosure than reporting a suspected illegal act if it is in the public interest.

Appropriate Authority

Paragraph 225.12 provides an imprecise definition for *appropriate authority*: “An appropriate authority is one with responsibility for such a matter.” Although it is clear that the appropriate authority to which to disclose the matter will depend on the nature of the suspected illegal act, it is not clear exactly which authority would be appropriate. A professional accountant providing professional services to an audit client may not have the requisite knowledge to determine who would be considered the appropriate authority for the disclosure of certain illegal acts.

Professional Accountants Providing Nonattest Services

Per the Exposure Draft, a professional accountant providing non-audit services to a client that is not an audit client and a professional accountant in business would be required to disclose suspected illegal acts to the entity’s external auditor. It would be beneficial for the external auditor to have knowledge of such a suspected illegal act in a timely manner.

Responses to Request for Specific Comments

In response to the questions posed in the Exposure Draft’s request for specific comments, we are also providing some additional comments below. These comments should be read in conjunction with, and are qualified by, our comments on the proposed standard set forth above.

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?

Yes. We believe it would be appropriate for a professional accountant to report suspected illegal acts to the appropriate levels of management of a client, and possibly with those charged with governance, if management’s response is not timely and appropriate.

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?



We believe that in exceptional circumstances and when the matter has not been appropriately addressed by the entity, the professional accountant should not be found in violation of the confidentiality requirements under the Code by disclosing an illegal act to an appropriate authority, and therefore should have a “right” (but not a requirement) to override the confidentiality requirements and make such disclosures.

This “right” (but not a requirement) would allow the professional accountant to evaluate possible implications of such disclosure outside the entity if appropriate legislative bodies had not established safe harbor “whistle-blower” protections.

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?

Please refer to our comments above under the caption “Disclosure in the Public Interest.”

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?

Yes. We agree that it may be appropriate to establish a standard for a professional accountant in public practice providing services to an audit client that differs from the standard for a professional accountant in public practice providing services to a non-audit client.

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?

No. We believe that the decision to disclose a matter to an appropriate authority ordinarily should lie with management and those charged with governance, not the professional accountant. The appropriate legislative bodies in each jurisdiction, and not the IESBA, should decide whether to impose a requirement or confer a right on a professional accountant to make such disclosures, accompanied by appropriate protective mechanism for the professional accountant.

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?

Yes. We believe it would be appropriate for such individuals to report suspected illegal acts to the appropriate levels of management of a client, and possibly with those charged with governance, if management’s response is not appropriate. However, we believe if the suspected illegal act relates to the client’s financial statements the non-auditor should bring the matter to the attention of the audit engagement partner and the audit engagement partner should escalate the matter, if appropriate.

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?

We believe that the decision to disclose a matter to an appropriate authority ordinarily should lie with management and those charged with governance, not the professional accountant. The appropriate legislative bodies in each jurisdiction, and not the IESBA, should decide whether to impose a requirement or confer a right on a professional accountant to make such disclosures, accompanied by appropriate protective mechanism for the professional accountant. However, we believe if disclosure were to be made, it would be appropriate to disclose certain suspected illegal acts that affect the client’s

financial reporting, or that relate to subject matters that fall within the expertise of other professional accountants at the firm.

8. Do respondents agree that 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?

We would support a requirement that professional accountants in public practice providing services to a client that is not an audit client of the firm or a network firm and professional accountants in business be required to consider disclosing a suspected illegal act to the external auditor, provided that such disclosure would not violate any legal or contractual confidentiality or non-disclosure requirements applicable to the accountant's engagement or employment. We also believe that if disclosure is considered to be appropriate the external auditor be informed in a timely manner.

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?

Please refer to our comments with respect to Question 2 above.

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?

We believe that the decision to disclose a matter to an appropriate authority ordinarily should lie with management and those charged with governance, not the professional accountant. The appropriate legislative bodies in each jurisdiction, and not the IESBA, should decide whether to impose a requirement or confer a right on a professional accountant to make such disclosures, accompanied by appropriate protective mechanism for the professional accountant. However, we believe if disclosure were to be made, it would be appropriate to disclose certain suspected illegal acts that relate to subject matters that relate to the subject matter of the professional services being provided by the professional accountant.

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?

We would support a requirement that professional accountants in business be required to consider disclosing a suspected illegal act to the external auditor, provided that such disclosure would not violate any legal or contractual confidentiality or non-disclosure requirements applicable to the accountant's engagement or employment. We also believe that if disclosure is considered to be appropriate the external auditor be informed in a timely manner.

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?

Please refer to our comments with respect to Question 2 above.

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?

We believe that the decision to disclose a matter to an appropriate authority ordinarily should lie with management and those charged with governance, not the professional accountant. The appropriate legislative bodies in each jurisdiction, and not the IESBA, should decide whether to impose a requirement or confer a right on a professional accountant to make such disclosures, accompanied by appropriate protective mechanism for the professional accountant. However, we believe it would be appropriate to require a professional accountant in business to encourage an employer to disclose to an appropriate authority certain suspected illegal acts that affect the employing organization's financial reporting, or that relate to subject matters that fall within the expertise of the professional accountant.

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?

We believe that the decision to disclose a matter to an appropriate authority ordinarily should lie with management and those charged with governance, not the professional accountant. The appropriate legislative bodies in each jurisdiction, and not the IESBA, should decide whether to impose a requirement or confer a right on a professional accountant to make such disclosures, accompanied by appropriate protective mechanism for the professional accountant. However, we believe it would be appropriate to require a professional accountant to consider encouraging a client to disclose to an appropriate authority certain suspected illegal acts that relate to subject matters that fall within the expertise of the professional accountant. As part of that consideration, we believe that it would be reasonable for a professional accountant to take into account exceptional circumstances that weigh against making such a recommendation.

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 be the exceptional circumstances be described?

Please see our response to Question 14 above.

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

No. While International Standards on Auditing require the documentation of issues addressed in connection with an audit engagement, the Code does not currently impose similar documentation requirements with the exception of documenting certain threats to independence and safeguards applied, when safeguards are required, to reduce threats to an acceptable level. We believe that, if the IESBA moves forward with the proposal, the standard should instead call upon a professional accountant to consider documenting such factors as his or her understanding of the suspected illegal act, the inquiries made by the accountant, and management's response.

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?

No. We believe that any changes to the existing sections of the Code discussed in the Exposure Draft should be consistent with our "General Comments." In particular, we do not believe that Section 140.7 of the Code should be amended to require professional accountants to comply with the requirements of proposed Sections 225 and 360, as currently drafted.

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?



We commend the IESBA for undertaking an impact analysis and including the analysis in the Exposure Draft. There are aspects of the analysis that we do not fully understand, however, as well as other factors that are not reflected in the analysis and which we believe warrant greater consideration.

The impact analysis identifies as “high” and “ongoing” the increased exposure of professional accountants to litigation, if they disclose suspected illegal acts to appropriate authorities and their suspicions turn out to be unfounded. Similarly, the analysis identifies the potential exposure of professional accountants to retaliation for making such disclosures as “high” and “ongoing,” since not all jurisdictions currently provide protective mechanisms to the accountants. These risks do not appear to be reflected, however, in the IESBA’s actual proposals. We believe they underscore why national regulators, which unlike the IESBA have the ability to provide protective mechanisms for professional accountants, should determine whether to impose a requirement, or confer a right, on a professional accountant to disclose suspected illegal acts involving clients or employers to external authorities.

In addition, the impact analysis states that, if the proposals were adopted, professional accountants in public practice who are not auditors and professional accountants in business would now “have a process for confirming or dispelling suspicion of illegal acts.” The proposals would require such professional accountants to “take reasonable steps” to confirm or dispel their suspicions, and identifies their obligations if they were unable to do so. However, they do not identify what steps or procedures would be considered “reasonable” to confirm or dispel an accountant’s suspicions, other than to state that the accountant may wish to consult with others within his or her their firm or, on an anonymous basis, with a relevant professional body. Accordingly, the proposed standard does not appear to provide professional accountants in public practice who are not auditors or professional accountants in business with a specific “process” for confirming or dispelling their suspicions in situations involving suspected illegal acts. In practice, we believe some firms might be required to devote significant time and expense to developing new policies and procedures for satisfying their responsibilities under the proposed standards. These costs are not reflected in the impact analysis.

The impact analysis also suggests that the proposals, if adopted, could lead to a possible reduction in the number of illegal acts because of the deterrent effect associated with a client’s or employer’s knowledge that a professional accountant would be required to disclose a suspected illegal act, or expected to exercise his or her right to disclose a suspected illegal act, to an appropriate authority. While the proposals, if adopted, might have some deterrent effect, we believe the impact analysis should also acknowledge that the existence of such disclosure obligations might also have a detrimental impact on the communications between professional accountants and their clients or employers. This could negatively impact the quality of the services provided by professional accountants, which would have a pervasive adverse impact all stakeholders.

We would be pleased to discuss our comments further with members of the IESBA or its staff. If you wish to do so, please contact Robert Dohrer (tel: +44 (0)207 601 1080; email: robert.dohrer@rsmi.com).

Yours sincerely

A handwritten signature in black ink that reads "Jean M Stephens".

Jean M Stephens
Chief Executive Officer
RSM International

A handwritten signature in black ink that reads "Robert Dohrer".

Robert Dohrer
Global Leader - Quality and Risk
RSM International