Responding to Non-Compliance with Laws and Regulations

ICAEW welcomes the opportunity to comment on the exposure draft *Responding to Non-Compliance with Laws and Regulations* published by IESBA on 6 May 2015 a copy of which is available from this link.

The Institute of Chartered Accountants in England and Wales
Level 1, Metropolitan House
321 Avebury Boulevard
Milton Keynes
MK9 2FZ UK

T +44 (0)1908 248 100
F +44 (0)1908 248 088
icaew.com

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MAJOR POINTS

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?**

   We are generally supportive of the revised guidance contained in the latest exposure draft, which we believe strikes a good balance between competing interests. However, the existence of domestic law and regulation in this area would override (and negate the need for) additional guidance in the Code of Ethics in many (possibly most) countries. The IESBA Code should not override laws and regulations and that must be made clear. The legal requirements of the jurisdiction should be the first consideration and this guidance interpreted in light of them.

   We are pleased that mandatory reporting is no longer being considered as we believe that would have resulted in unintended and adverse consequences, potentially reducing the ability of accountants to influence potential non-compliance.

   We are also pleased that disclosure is precluded where there is a conflict with local laws and regulations, an example being tipping off concerns under AML legislation where a discussion with management may not always be lawfully appropriate in such cases.

   We are conscious that there may be certain territories where domestic legislation on professional secrecy might make wider disclosure difficult so this will have to be subject to prevailing legal requirements.

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?**

   Our understanding of the public interest concept is that the responsibility to act in the public interest rests with the profession as a whole which will develop such requirements with the public interest in mind. Therefore individual accountants discharge that obligation by following the requirements of the professional codes.

   In this context it is apparent that the exposure draft has been developed with public interest considerations in mind. Clearly, given the framework adopted, some criteria needs to be adopted for accountants to decide when to override confidentiality and make disclosure, and it is not unexpected for the public interest to be used as the basis of such criteria. However we believe it is important not to suggest that some separate obligation to act in the public interest rests with the individual accountant.

   Furthermore, no consistent definition of public interest exists and the term is often misused. The concept has not been developed fully enough to overcome issues of subjectivity and differing approaches internationally. The concept should therefore not be used too liberally without detailed criteria as to how it can be assessed. Care should also be taken to avoid the phrase being used as a way of extending general law enforcement responsibilities to the profession.

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 would hope that the effect on audits carried out under ISAs would be negligible given the existing requirements under ISA 250. However care should be taken not to go too far beyond the requirements of current ISAs. Particular difficulties could arise in having a requirement to consider NOCLAR that may occur. Under current ISAs the only area where an auditor is required to look to the future is in respect of going concern, a well-developed concept which is more widely understood. The exposure draft, on the other hand, requires such foresight in respect of whether or not NOCLAR will occur that results in substantial harm (see our comment in paragraph 8), which is significantly more subjective and subtle than the going concern concept, and in its infancy as a threshold in the Code of Ethics.

Difficulties may also arise where the auditor is required to prompt management to take further action. If the auditor is expected to prompt or encourage management to address a particular issue then this could easily be construed as advice. Where such advice is given on a matter which goes beyond simply addressing a material misstatement then it becomes general business advice and the auditor may be in danger of involvement in the running of the business. Not only does this present immediate issues with regard to independence but they could also be in a position where they are auditing the results or consequences of that advice in the following year.

Additionally the auditor may be accused of providing advice extending beyond their area of expertise, resulting in liability issues.

Please also see our comments on public interest in paragraph 2.

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

Whilst the additional clarity over the expectations placed upon members of IFAC bodies is welcome, the need to maintain our reputation as a profession of trusted advisers should be emphasised. It is in the public interest for persons to have access to advice and representation without the risk that information concerning their affairs will be unnecessarily disclosed to parties outside the professional relationship. Such sensitivity might be particularly important in engagements involving, for example, forensic services. Furthermore, whilst the proposed guidance is clearer on domestic legislation taking precedence, the weight to be attached to contract law is less clear.

(c) PAIBs and their employing organizations.

For a PAIB there may be difficulties in deterring prospective rule breaking. This should be limited to explaining the expected breach and its consequences; the effective delivery of good advice. It should not, for example, involve usurping the rights of management by filing correct returns to supersede false ones. Whilst good professional judgement should mitigate the likelihood of the latter it is not explicit in the exposure draft that deterrence should not in itself involve subversive and possibly unprofessional behaviour itself.

RESPONSES TO SPECIFIC QUESTIONS

Specific Matters

Q1: Do respondents agree with the proposed objectives for all categories of PAs?

4. .We are broadly supportive of the proposed objectives for the categories of professional accountant, subject to our comments above regarding deterring breaches and heavy handed usage of the nebulous concept of public interest. Clearly, given the framework adopted, some criteria need to be adopted for accountants to decide when to override confidentiality and make disclosure, and it is not unexpected for the public interest to be used as the basis of such

criteria. However we believe it is important not to suggest that some separate obligation to act in the public interest rests with the individual accountant.

Q2: Do respondents agree with the scope of laws and regulations covered by the proposed Sections 225 and 360?

5. We are supportive of the approach to deciding which laws and regulations are relevant. An accountant cannot be expected to be an expert in legal matters. However it is not unreasonable that they understand their client's operating environment and therefore the key regulatory frameworks, failure to adhere to which could make or break the business.

Q3: Do respondents agree with the differential approach among the four categories of PAs regarding responding to identified or suspected NOCLAR?

6. We are broadly supportive of the proposed categories of PA and the guidance for each. It should be noted that audit is often a state mandated legislative requirement within which practitioners have, not only statutory obligations, but also requirements under auditing standards such as ISAs to which to adhere. The requirements of the exposure draft appear to underpin this and it would be difficult to justify extending similar requirements to those providing non audit services the output of which is defined by private contractual agreement.

7. We foresee difficulties in distinguishing a Senior PAIB (director, officer or senior employee capable of exerting significant influence) from an Other PAIB. There may be a risk that an over-zealous regulator, with the benefit of hindsight, may adopt a form over substance approach in an effort to assign additional responsibilities on a particular individual.

Q4: 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?

8. Further thought is required over the concept of 'substantial harm' derived from SEC regulations. We have concern that this is a new concept for the Code, adapted from a well-developed code of conduct but one grounded firmly in a regulatory environment. There is therefore a danger that where clarity is sought as to whether a matter constitutes substantial harm, the only useful precedents available will be those developed under a regulatory lens. This may be unsuitable in attempting to apply a principles based code.

9. Some original examples of 'serious adverse consequences' might therefore be useful, and it may be that material misstatement will not always have serious adverse consequences.

(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?

10. Many accountants will be familiar with such a test. For example, it is explicit in the relevant sections on safeguards (110.2) and independence (290.6). However it should be noted that in both these examples, considering the perception of a reasonably informed third party is an integral part of a threats and safeguards approach. The exposure draft is instead dealing with specific guidance on unique situations where there may be a need to override a fundamental principle. This is a very different analytical context.

(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?

11. No list of examples in this area can ever be exhaustive, nor should it be. IESBA might consider putting such examples in an appendix to facilitate future review and update.

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

12. It should be clear that the Code of Ethics is principles based and the list of factors to consider in determining whether to disclose does not replace professional judgement. It should also be clearer that where there is an appropriate body to receive the information that the specific reporting route of that body should be used.

Q4: 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?

13. We are conscious that there may be certain territories where domestic legislation on professional secrecy might make this difficult so this will have to be subject to prevailing legal requirements. The exposure draft generally gives little guidance on how to deal with cross border engagements and this could be considered a shortcoming.

Q5: Do respondents agree with the approach to documentation with respect to the four categories of PAs?

14. We support the respective recommendations regarding documentation.