

## Responding to non-compliance with laws and regulations

An exposure draft issued by the International Ethics Standards Board for Accountants

Comments from ACCA

September 2015

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Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability. We believe that accountants bring value to economies in all stages of development. We aim to develop capacity in the profession and encourage the adoption of consistent global standards. Our values are aligned to the needs of employers in all sectors and we ensure that, through our qualifications, we prepare accountants for business. We work to open up the profession to people of all backgrounds and remove artificial barriers to entry, ensuring that our qualifications and their delivery meet the diverse needs of trainee professionals and their employers.

We support our 178,000 members and 455,000 students in 181 countries, helping them to develop successful careers in accounting and business, with the skills required by employers. We work through a network of 92 offices and centres and more than 7,100 Approved Employers worldwide, who provide high standards of employee learning and development. Through our public interest remit, we promote appropriate regulation of accounting and conduct relevant research to ensure accountancy continues to grow in reputation and influence.

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ACCA welcomes the opportunity to comment on the proposals issued by the International Ethics Standards Board for Accountants (the IESBA). The ACCA Global Forum for Ethics has considered the matters raised, and the views of its members are represented in the following.

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## OVERALL COMMENTS

We are supportive of the IESBA's efforts to address the significant concerns expressed following the previous consultation, and explore more appropriate responses by professional accountants to instances of non-compliance (or suspected non-compliance) with laws and regulations. The current exposure draft represents a considerable improvement, although the effectiveness of the proposals will be dependent upon local practice, including the laws and regulations in various jurisdictions, and how they are drafted, interpreted and enforced.

Confidentiality is an implied term of a professional accountant's contract with their client, and it is in the public interest that this confidential relationship is maintained. Without the benefit of confidentiality a client might be reluctant to seek advice from a professional accountant. However, unintended defaults or unlawful acts may be averted as a result of the client acting on the professional accountant's advice, because the client is able to discuss their plans in confidence. It may also be argued that the public interest is served by encouraging a strong economy, with businesses (particularly SMEs) having access to the advice of professional accountants, which helps businesses (and economies) to grow. Such advice is only sought in an environment of trust, in which confidentiality plays a very important part.

Most importantly, the proposals within the current exposure draft attempt to strike a complicated balance between responding to expectations that a professional accountant will act in the public interest (whether by making the appropriate disclosures or by safeguarding confidentiality) and recognising the need to comply with local laws and regulations. For reasons explained throughout this paper, we are pleased that disclosure beyond those charged with governance is not to be mandatory. Furthermore, if a professional adviser was seen to have a policing function, clients and employers may be persuaded to seek the services of accountants who are not subject to the Code, which would surely not be in the public interest.

We believe that the proposals are well-balanced, and recognise the differences between the roles of auditors and other professional accountants. However, the proposals are not always clearly expressed in sections 225 and 360 as drafted. Their structures do not aid understanding, and so may not be successful in

bringing about high standards of behaviour in the public interest. We also highlight below several areas in which the proposals lend themselves to detailed guidance alongside the Code, and such guidance may be related to roles and relationships with different types of entity (including SMPs and SMEs). Many issues covered by such guidance would be particularly suitable for illustration by way of case studies.

We would question whether the exposure draft should do more to address situations involving cross-border engagements, including group audits. It may be the case that a disclosure (to a group auditor or appropriate authority) would be permitted in one jurisdiction but prohibited in another.

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## SPECIFIC ISSUES

In this section of our response, we answer the nine questions set out in the consultation paper section *Request for Specific Comments*.

**Question 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?**

Broadly, we would agree that the proposed guidance would support the application of local legal or regulatory requirements in a particular jurisdiction. However, care must be taken to ensure that the drafting of the two new sections of the Code achieves clarity (without being prescriptive) in order to further the objective of meeting the expectations of stakeholders. (See our response to question 2 below.)

We are pleased to note that there is not to be a mandatory disclosure provision, and we welcome the clear statement (in each new section) that '[d]isclosure would be precluded if it would be contrary to law or regulation'. However, we feel that it would have a greater impact if positioned alongside the statement that appropriate disclosure would not be considered a breach under section 140 of the Code.

Discussions with management should also be precluded in situations where it would be contrary to local laws and regulations, such as where it would amount to 'tipping-off' under anti-money laundering legislation. We believe this needs further clarification in section 225 in particular.

**Question 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?**

ACCA is broadly supportive of the differential approach and the four categories of professional accountant set out within the proposed sections of the Code. (See question 6.) However, we perceive the proposed structure of sections 225 and 360 to be potentially confusing and unnecessarily repetitious, while there are also inconsistencies between paragraphs that, we believe, are intended to be consistent. For example:

- We believe that section 225 should start by setting out the responsibilities of management and those charged with governance, followed by the purpose and scope of the provisions. The responsibilities of all professional accountants in public practice should then be set out, followed by the additional responsibilities of those performing audits of financial statements. This would provide less scope for inadvertent inconsistencies, and make it easier for the professional accountant to be clear about his or her responsibilities in different situations.
- A similar structure would enhance clarity within section 360. This approach would also make it easier for paragraphs such as 360.15 to explain the subtly different responsibilities of the senior PAIB compared with the requirements of paragraph 360.32. In such context, the definition of a senior PAIB would also be easier to understand.
- An example of an unexpected inconsistency between the provisions relating to auditors and those relating to other professional accountants in public practice is paragraph 225.16 (which only appears to apply to auditors). Surely, this would be useful guidance to all professional accountants in public practice.
- Similarly, paragraph 225.22 includes guidance on relevant considerations that would be useful to all professional accountants in public practice. Although the information on which to judge the response of management is more likely to be available to auditors than to others, as guidance, it should not be restricted to auditors by the way in which this section of the Code is structured.
- Paragraphs 225.3, 225.17 and 360.3 all consider the purpose of alerting management or those charged with governance. In respect of a non-compliance that has already occurred, there is no mention of management taking action to address the non-compliance with the person responsible.
- Paragraphs 225.3 and 360.3 state that the objectives of the professional accountant include taking ‘such further action as may be needed in the public interest’. The use of the word ‘needed’ would suggest that the public interest can always be identified and that there

may, on occasions, be a *requirement* for the professional accountant to disclose the matter to an appropriate authority. Therefore, we proposed that the word ‘needed’ should be replaced by the word ‘appropriate’.

- In considering what constitutes the public interest, paragraphs 225.4 and 360.4 refer to immediate or ongoing consequences, but omit reference to probable consequences.
- Guidance on withdrawing from an engagement or resigning is expressed in different ways throughout the proposed sections 225 and 360. In itself, withdrawing or resigning does little to further the objectives of the professional as set out in paragraphs 225.3 and 360.3. We suggest it should be removed from paragraphs 225.24 and 360.23, but expanded upon in paragraphs 225.30 and 360.29, so that the context and relevance of withdrawing or resigning are made clear.
- For a professional accountant in public practice whose firm is not auditor of the client entity, paragraph 225.43 proposes disclosure to the external auditor as a possible further action, but does not explain to what end.
- The two proposed sections provide guidance on determining whether to disclose a matter to a relevant authority, but do not consider the timeliness of possible disclosure or the means by which the disclosure should take place.
- For greater clarity, paragraph 225.29 should reiterate the importance of seeking advice, while safeguarding confidentiality. We also suggest that the statement at the end of paragraph 225.27 that disclosure would be ‘precluded if it would be contrary to law or regulation’ would be better placed next to the statement in paragraph 225.29 that appropriate disclosure would not be considered a breach under section 140 of the Code. Similar comments apply to paragraphs 225.44 and 225.45, paragraphs 360.26 and 360.28, and paragraph 360.34.
- The documentation provisions in paragraph 360.35, which apply to all PAIBs, omit reference to discussions with the PAIB’s immediate superior (in the case of a PAIB who is not a senior PAIB).

It is important to make this guidance as clear as possible, in order to bring about the required behaviours of professional accountants. With this in mind, the impact of the threat of legal liability perceived by the professional accountant must not be underestimated.

We believe that the proposals will be helpful in guiding professional accountants in fulfilling their responsibility to act in the public interest. However, for accountants in public practice, their obligations must not be extended beyond those under International Standards on Auditing. For example, under ISA 250, *Consideration of Laws and Regulations in an Audit of financial statements*, paragraph 10 states that the objectives of the auditor are:

- ‘(a) To obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements;
- (b) To perform specified audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements; and
- (c) To respond appropriately to non-compliance or suspected non-compliance with laws and regulations identified during the audit’.

**Question 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;**
- (b) other PAs in public practice and their clients; and**
- (c) PAIBs and their employing organizations.**

Many elements of the financial reporting system already have fiduciary or other legal and professional responsibilities in addressing instances of non-compliance. These may be mandated in local laws (eg anti-money laundering). The issues are how clear the laws are, what the thresholds are for reporting non-compliance, and consistency between the various jurisdictions. Often, of course, there are no bright lines in respect of how and when to report. This creates problems for professional accountants, clients and employing organisations.

(a) Previous concerns have included the possibility that communications between auditors and audited entities would be stifled due to additional reporting obligations being placed upon auditors. Therefore, we support the changes to the proposals in this respect, and we believe that relationships will be maintained, because the reporting obligations of auditors will be consistent with the requirements of ISAs.

(b) In our opinion, it is unclear what impact the current proposals will have on relationships between other professional accountants in public practice and their clients. Many might assume that guidance that encourages appropriate disclosure of non-compliance would discourage certain communications. However, if (as is intended) clients regard their accountants as ethical professionals, who have always observed their responsibility to act in the public interest, one might assume that the current proposals will have no further impact on communications.

With regard to all professional accountants in public practice, we feel that certain requirements may present a risk of disproportionate costs being incurred by clients. For example, paragraphs 225.11 and 225.34, as drafted, might suggest that the professional accountant has a responsibility to gain a deeper understanding of laws and regulations – requiring resource within the firm and perhaps externally in the form of legal expertise.

(c) The current proposals would encourage PAIBs to be whistle-blowers in certain situations. In such situations, legal protection for the PAIB must be adequate, and this is not obvious from the structure of proposed section 360. In exceptional circumstances, according to paragraph 360.34, a PAIB who is not senior may consider it 'appropriate' to act as a senior PAIB would, and so refer to paragraph 360.26, although paragraph 360.13 clearly states that paragraph 360.26 applies to senior PAIBs. In short, this lack of clarity makes it unlikely that there will be any change in relationships, as there will be a resistance to any change in behaviours. We suggest that this could be rectified by changing the structure of section 360, and creating detailed guidance and case studies to complement the revised Code. Nevertheless, the Code should make clear that the obligations of PAIBs do not extend beyond providing information and appropriate advice to those charged with governance.

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

ACCA broadly agrees with the proposed objectives, as they support the fundamental principle of professional behaviour, and are consistent with the need for professional accountants to comply with relevant laws and regulations and avoid any action (or inaction) that discredits the profession. We note that several elements of the paragraphs claiming to set out the objectives of the professional accountant read more like principles than objectives. We suggest, therefore, that there would be benefits in explaining these objectives in the context of the fundamental principles when setting out the purposes of sections 225 and 360.

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

Yes, we agree with the scope as set out in the proposed new sections of the Code – particularly as it aligns the scope with that of ISA 250. The examples set out in paragraphs 225.6 and 360.6 are helpful, although it would be useful to emphasise that any list of examples is not exhaustive. These examples suggest areas in which detailed guidance and case studies would usefully support the Code itself.

It should also be noted that the ability of the professional accountant to recognise instances of non-compliance will depend upon the experience of the individual and his or her role. (In the case of some IFAC member bodies, these provisions of the Code could also relate directly to student accountants.) We believe that this has not been fully acknowledged in the proposed drafting.

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

Yes, we agree with the differential approach among the four categories of professional accountant although, as already expressed, the proposed structure of sections 225 and 360 could be greatly improved, in order to enhance clarity and bring about higher standards of behaviour.

With all professional accountants, the expectations of others regarding their abilities and public interest responsibilities to respond to non-compliance will depend upon their role, experience and status. Section 225 appears to have successfully drawn a distinction in a reasonable place. However, a distinction is more difficult to draw in the case of PAIBs. It is reasonable to have higher expectations of senior PAIBs than other PAIBs, although the difference between the two categories is difficult to articulate.

We would, in fact, question the need to define a senior PAIB – the need for which has come about from the structure of section 360. If that section was to start by explaining the responsibilities of all PAIBs, and then explain the additional responsibilities of more senior PAIBs, the context of those additional responsibilities would make it easier to see the differences in the various types of role, and for PAIBs to apply the Code to their own circumstances.

**Question 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?**

Broadly, we agree with the factors to consider in determining the need for, and the nature and extent of, further action. However, we feel that an assessment of ‘urgency of the matter’ in this context is not sufficiently explicit. If these sections are to address possible future non-compliance as well as past non-compliance, this should be acknowledged in these lists of factors, and urgency should be expressed specifically in terms of the expected timing of future non-compliance.

Each section goes on to discuss factors to consider in judging the appropriateness of the response of management, those charged with governance or others. However, when comparing paragraphs 225.22 and 360.21, it is unclear why the format of each is so different.

With regard to the threshold of credible evidence of substantial harm, we feel that such a threshold is appropriate, and is reasonably expressed in those terms. We feel that seeking to remove all subjectivity from this threshold (eg words such as ‘substantial’) would stray too far from a principles-based approach, which is essential in the context of such decision making, especially where there are public interest considerations. Nevertheless, this highlights another area that would be appropriate for further guidance and examples, perhaps in the form of case studies, issued alongside the Code.

**(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?**

Yes, we agree with the use of the third party test when a situation requires judgement, as it helps to reduce the impact of subjectivity. It also encourages the professional accountant to consider the appearance of his or her decisions to others, and so introduces an element of challenge. The third party perspective also assists with knowing how to document the decision making process.

**(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?**

In answering this question, we assume that auditors will comply with the communication and reporting requirements of International Standards on Auditing. Therefore, the only additional action available to a professional accountant is to disclose the matter to an appropriate authority. It is unclear why withdrawing from the engagement (225.24) or resigning from the employing organisation (360.23), is relevant to addressing the non-compliance (although it may be appropriate to disassociate oneself from the entity for other reasons). We note that withdrawing from the engagement is not included within paragraph 225.43.

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

Yes, we support the list of factors in each section, and we are pleased to note that it includes whether there exists robust and credible protection from civil,

criminal or professional liability. This level of clarity regarding protection for the professional accountant should be sought throughout sections 225 and 360. In particular, we note that such protection is mentioned, in paragraph 225.27, as something to consider, but not in paragraph 225.21 as a factor affecting the *need* to take further action. Therefore, the impact of a lack of protection from civil, criminal or professional liability is unclear.

**Question 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?**

Yes, we agree with the proposed level of obligation with respect to communicating the matter to a network firm, and we agree with the reasons articulated in paragraph 77 of the explanatory memorandum. We also understand why addressing the relevant complexities within section 225 would detract from the broader principles within the proposals. However, we are concerned that a professional accountant will see the words ‘consider whether to communicate’ as having no weight whatsoever. We believe that the way to address this is in guidance alongside the Code, which may explain (with examples) why a professional accountant might determine that it is either appropriate or inappropriate to communicate the matter to a network firm.

There may also be practical challenges associated with communicating the matter to a network firm. These relate primarily to group audit situations, particularly where the group exists across a number of jurisdictions, in which legal and regulatory requirements vary. While addressing such complexities within the Code carries the risk of detracting from the broader principles, clarity is important. For this reason, we recommend the use of detailed guidance alongside the Code itself.

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

We agree with the approach to documentation with respect to the four categories of professional accountant. We note that there are inconsistencies in the requirements. For example, paragraph 225.32 refers to the documentation of the decisions made, ‘having regard to the reasonable and informed third party perspective’, but this helpful requirement is not included within the encouragement to document matters in paragraphs 225.48 or 360.35.

