



International Organization of Securities Commissions
Organisation internationale des commissions de valeurs
Organizaç o Internacional das Comiss es de Valores
Organizaci n Internacional de Comisiones de Valores

22 January 2013

Deputy Director
International Ethics Standards Board for Accountants
545 Fifth Avenue, 14th Floor
New York, NY 10017 USA

Our Ref: 2013/JE/C1/IESBA/6

Subject Line: IESBA's Exposure Draft, *Responding to a Suspected Illegal Act*

Dear Sir:

The International Organization of Securities Commissions' Committee on Issuer Accounting, Audit and Disclosure (Committee 1) appreciates the opportunity to comment on the IESBA's Exposure Draft: *Responding to a Suspected Illegal Act* (the Paper). As an international organization of securities regulators representing the public interest, IOSCO is committed to enhancing the integrity of international markets through promotion of high quality accounting, auditing and professional standards, other pronouncements and statements.

Members of Committee 1 seek to further IOSCO's mission through thoughtful consideration of accounting, auditing and disclosure concerns, and pursuit of improved global financial reporting. Unless otherwise noted, the comments we have provided herein reflect a general consensus among the members of Committee 1 and are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.

The Project

We support efforts to improve the *Code of Ethics for Professional Accountants* (the Code) so that it provides better guidance to professional accountants in both business and in public practice with respect to the considerations they can and should make if they encounter a suspected illegal act as part of carrying out their employment or engagement responsibilities, respectively. In referencing suspected illegal acts, we believe the Code should specifically mention that illegal acts encompass suspected frauds.

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Previous SC 1 Input on the Project

In the context of the IAASB's previous work on the responsibilities of an auditor to consider fraud as part of an audit of financial statements, our predecessor committee, known as SC 1, commented on this subject in a 2004 comment letter to the IAASB. In that letter SC 1 stated that it believed the current Code and its professional obligations of auditors should be reconsidered with respect to balancing the auditors' obligations for confidentiality to the entity it is auditing and its duties in serving the public interest when, during the course of an audit, it encounters fraud at the audit client.

We believe that SC 1 was concerned that the client confidentiality provisions of the Code leave the auditor with (only) two "tools" for considering client frauds that it encounters during the course of its financial statement audit work. These two tools are (i) issuance of a modified auditor's report and (ii) resignation from the audit engagement. SC 1 encouraged the IAASB to look beyond these two tools because modification of the auditor's report may not be available if the auditor had access to the necessary audit evidence and the audit client's reporting with respect to the suspected fraud met the requirements of its financial reporting framework. And additionally, the "all or nothing" choices of either continuing with or resigning from the audit engagement present starkly different alternatives.

Current Direction of the Project

For auditors, the overall direction of the Paper seems to swing the pendulum quite far away from their existing obligation of confidentiality. This is because the Paper proposes that, except in the case of anticipated bodily harm, auditors are called to report to regulators those suspected illegal acts that management does not itself report, regardless of whether the auditor's expertise and work has a nexus to the regulator and without regard to the regulator's means to intake, process and/or carry out the enforcement of the laws governing the related matter. In short, under the Paper it seems like the auditor's overall mandate under the Code would go from "report nothing" to "report what management does not report."

Our overall comment in response to the Paper's proposed shift in the auditor's role is to reiterate the overall comment made in SC 1's 2004 comment letter; that is, to call for the proper balance with respect to what the audit firm is both called upon and allowed to do under the Code and/or the ISAs in handling the various scenarios involving suspected illegal acts. Our preference at this time is to ask the IESBA to redeliberate its way to the proper balance as part of piecing together the input it has received on the Paper, versus for us to declare a particular approach as the one that we think should be definitive. Having said this, we may have further thoughts in reaction to the Board's redeliberations.

Redeliberations of the Paper

As a way to discern the best approach to the Code's/ISA's expectations of auditors, as well as the Code's expectations of accountants in business and those accountants providing other professional services, we suggest the IESBA's redeliberations would benefit from including the steps noted below.

Scope

Establish whether this project will encompass both suspected illegal acts that an accountant or auditor encounters while the act is being planned (e.g., authorization of an illegal payment that has not yet been made) as well as those that are identified after the act has occurred.

Establish whether this project will encompass acts of personal misconduct that are associated with employment (e.g., employees or their close family members selling company shares at inappropriate times).

Responsibilities of Management and Those Charged With Governance

Redeliberate the Code's expectations for what an accountant in business should do when s/he encounters a suspected illegal act. Accountants in business are the first line of defense within the accounting profession for handling suspected illegal acts that are discovered at the enterprise where they work. Further, the responsibility for an entity's compliance with laws and regulations is that of management, as overseen by those charged with governance of the enterprise.

Responsibilities of the Auditor

Review how the existence of a suspected illegal act at an audit client affects the auditor's work to complete its audit of the entity's financial statements (e. g., within the typical steps of risk assessment, planning, evidence gathering and verification, sharing information with management and those charged with governance, applying professional skepticism, supporting conclusions regarding the operation of internal controls and whether they can be relied upon, and so forth). In particular, consider the scenarios in which management does not agree with the auditor that a suspected illegal act exists or agrees that it exists but does not agree with what is called for to handle it; that is, the level of fact gathering needed to assess it and its effects on the financial statements and/or whether there are requirements that call for management to report the suspected illegal act to the relevant authorities. This review would inform the IAASB as to whether it should propose any changes to the ISAs, including to ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* and to ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*.

Establish the suspected illegal acts for which the auditor is called to take steps that are incremental to what is called for by the ISAs. For example, at one end of the spectrum is a suspected illegal act in which neither management nor those charged with governance are involved, and for which both management and those charged with governance believe that management has taken the proper steps in handling it. At the other end of the spectrum is a suspected illegal act in which both management and those charged with governance are involved, and for which they do not agree that the matter is in question.

Establish what incremental steps the external auditor is called to take beyond those called for by the ISAs. As part of its work to establish the incremental steps an auditor would take, our members believe that the Board should:

- A. Revisit the role of the "public interest" filter, since it seems that it would be in the public interest for any suspected violation to be subjected to the appropriate handling.
- B. Make clear that reporting to the appropriate authority would not be considered a breach of the Code and that the auditor should comply with legal obligations even if such duties may be in conflict with professional obligations, such as the obligation for confidentiality of client information.
- C. Require the auditor to consider whether resignation from the engagement is also necessary. This determination should be made after the appropriate consultations both at the local engagement team level and escalation within the audit firm.

- D. Require the predecessor auditor to notify a successor auditor of the suspected illegal act—prior to the latter’s final acceptance of the engagement—so that the successor auditor understands the risk of accepting the engagement.
- E. Establish the timing for the situations in which auditors are involved in the reporting of suspected illegal acts to appropriate authorities.
- F. Call for the auditor to re-assess the integrity of management.

Responsibilities of Professional Service Providers

Establish what incremental steps an audit firm should take if the matter is discovered in providing a non-audit service to an audit client.

Establish any incremental steps beyond those taken by management and those charged with governance that an audit firm should take if the matter is discovered in providing a non-audit service to a non-audit client.

Interaction with the IAASB’s Work on Auditor Communications

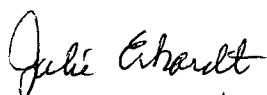
We realize that the IAASB’s current project on auditor communications is targeted at improving what an auditor communicates as a result of completing the audit of an entity’s financial statements. Depending on the timing, the IESBA could coordinate with the IAASB’s conclusions from this project and/or establish the incremental steps noted above relative to the existing ISA requirements for auditor reporting.


Resources

Our members have a variety of experiences with “whistleblowing” and the reporting of and handling of reported suspected illegal acts, including frauds. These experiences include determining how best to draw upon the skills, incentives and resources of management, of those charged with governance, and of outside parties (such as auditors and securities regulators) in the handling of suspected illegal acts. Our members would be pleased to discuss their experiences with representatives of the IESBA if the Board would find this helpful.

Thank you for the opportunity to comment on the Paper. If you have any questions or would like to further discuss the matters discussed in this letter, please contact either Nigel James or me at 202-551-5300.

Sincerely,



Julie A. Erhardt ^{by} 
Chair
Committee 1
International Organization of Securities Commissions