



12 December 2012

Our Ref.: C/EC

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

Dear Sirs,

International Ethics Standard Board for Accountants Exposure Draft on Responding to a Suspected Illegal Act

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only statutory licensing body of accountants in Hong Kong responsible for the professional training, development and regulation of the accountancy profession. The HKICPA sets auditing and assurance standards, ethical standards and financial reporting standards in Hong Kong. We welcome the opportunity to provide you with our comments on the captioned IESBA Exposure Draft.

HKICPA acknowledges that it is of paramount importance for the accountancy profession to accept the responsibility to act in the public interest and a professional accountant's responsibility is therefore not exclusively to satisfy the needs of an individual client or employer. However, we have substantial concerns on whether the proposals will result in the imposition of fair and equitable requirements to professional accountants, especially in the absence of adequate statutory protection for whistle-blowers. We understand that such statutory protection is not commonplace around the world.

The proposed requirement may also create the impression that a professional accountant is a "policeman" or "informant" and this may jeopardize the relationship between professional accountants and their clients or employers and promote mutual mistrust. For the professional accountants in business ("PAIB"s), this would directly affect their competitiveness as compared with someone other than a professional accountant. Without appropriate statutory whistle-blowing protections in place, there is a possibility that the PAIBs, especially for those who are more senior and influential in society, who do not need an accounting qualification will terminate their professional accountant qualification in reaction to the potential effect of the proposals.

We also consider it may not be equitable to impose requirements, to the extent proposed, to professional accountants where comparable requirements are absent for lawyers, engineers, medical practitioners and other professionals. This proposal may discourage the next generation from entering the accounting profession, which could jeopardize the ongoing development and sustainability of the profession.

Please find in the attachment our comments on the specific questions asked. Our comments reflect the views that we have received in our various outreaching activities to stakeholders,



which include: written response to our local invitation to comment, consultative forum and electronic survey open to all stakeholders.

We trust that our comments are of assistance to you. If you require any clarifications on our comments, please do not hesitate to contact Ambrose Wong, Manager of Standard Setting at ambrose@hkicpa.org.hk.

Yours faithfully,

Simon Riley
Director, Standard Setting

SR/AW/jn

Encl.



Hong Kong Institute of
Certified Public Accountants
香港會計師公會



INVITATION TO COMMENT ON IFAC'S INTERNATIONAL ETHICS STANDARDS BOARD FOR ACCOUNTANTS (IESBA) EXPOSURE DRAFT ON RESPONDING TO A SUSPECTED ILLEGAL ACT

Request for Specific Comments

- 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?**

We have substantial concerns with the above-mentioned proposal, which would require a professional accountant when encountering a suspected illegal act to take reasonable steps to confirm or dispel the suspicion and to discuss the matter with the appropriate level of management. If the response of those with whom the matter has been discussed is not appropriate, the professional accountant shall escalate the matter to higher levels of management and those charged with governance, as appropriate.

We understand that the IESBA is of a view that through escalating the matter the professional accountant would obtain additional information about the suspected illegal act. This would mean that before reaching the stage where disclosure to an appropriate authority might be expected or required, the professional accountant would have been able to confirm or dispel a reasonable level of suspicion.

In our view, professional accountants may encounter significant practical difficulties in considering whether the level of suspicion on a matter is high enough to warrant disclosure given the subjectivity involved. Moreover, there are possibilities that illegal acts, if any, are directed and committed by top management. By escalating the matter to a higher level of management, the professional accountant may be effectively "tipping off" the concerned personnel and consequently lead to the concealing of important evidence. Potentially, this could also put a professional accountant at risk of breaching anti-money laundering laws, which may impose criminal liabilities on tipping off a possible suspect. Escalating a matter might also promote mistrust in the relationship between the professional accountant and client. The professional accountant may be viewed as "policeman" or "informant", which would directly affect the way they discharge their professional responsibilities or continuation of providing services to clients or employing organisations.

There may also be a possibility that, through escalating the matter, the professional accountant may be constrained in obtaining additional information where



management/client undertake work or investigations that are under privilege and the professional accountant is outside of that privilege.

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 agree in principle for the Code to afford professional accountants the right to override confidentiality and disclose certain illegal acts to an appropriate authority if the matter has not been appropriately addressed by the entity.

However, it appears to us that the proposal is imposing an obligation on the professional accountant, but not a discretionary right, to disclose a suspected illegal act as the proposal explicitly states that the professional accountant would be expected to exercise this right in order to fulfill their responsibilities to act in the public interest. We consider that the decision on whether to make such disclosure to an appropriate authority should rest within the discretion by the professional accountant after considering all the facts and circumstances including among other things, requirements under local laws, regulations or standards, and the Code should not impose on the professional accountant additional requirements in terms of whether they need to explain their approach and reasoning should they choose not to make such a disclosure.

Having said that, we consider there might be practical difficulties for professional accountants to exercise a discretionary right if they would likely need to bear personal liability for compromising their confidentiality obligation under the local laws and regulations. Therefore, professional accountants will need to consider carefully when and how to exercise any discretionary right.



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?

We consider the guidance included in the existing Code is sufficient in the meantime to assist a professional accountant to act in the public interest. Currently, paragraph 140.7 of the current Code highlights the circumstances where professional accountants are or may be required to disclose confidential information or when such disclosure may be appropriate:

"(a) Disclosure is permitted by law and is authorized by the client or the employer;

(b) Disclosure is required by law, for example:

- (i) Production of documents or other provision of evidence in the course of legal proceedings; or*
- (ii) Disclosure to the appropriate public authorities of infringements of the law that come to light; and*

(c) There is a professional duty or right to disclosure, when not prohibited by law:

- (i) To comply with the quality review of a member body or professional body;*
- (ii) To respond to an inquiry or investigation by a member body or regulatory body;*
- (iii) To protect the professional interests of a professional accountant in legal proceedings; or*
- (iv) To comply with technical standards and ethics requirements."*

Based on the above, we are concerned as to the appropriateness, and lack of clarity in, the proposed threshold for suspected illegal act reporting.



Matters specific to professional accountants in public practice (Section 225 of the Code)

- 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?**

We consider the role of a professional accountant in public practice providing services to a client that is not an audit client, and a professional accountant in business are more fiduciary in nature towards the client and employer. Without necessarily agreeing to the proposals as they would impact on a professional accountant in public practice providing services to an audit client, we consider the standard for such a professional accountant should be different from the standard for a professional accountant in public practice providing services to a client that is not an audit client and a professional accountant in business: for example, the auditor owes a duty to a company's shareholders whereas the non-auditor does not.

- 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?**

We have substantial concerns with the above-mentioned proposal, which would require an auditor to override confidentiality and disclose certain suspected illegal act to an authority if the entity has not made adequate disclosure within a period of time after being advised to do so.

We consider that the law and law enforcement mechanism in any given jurisdiction should have already reflected the public expectation on an auditor's disclosure of a suspected illegal act and therefore there is no need to impose additional obligations under the Code over and above what is required by the local law.

Laws inherently differ between jurisdictions and many jurisdictions do not have an adequate level of whistle-blowing protection legislation in place. We consider it is necessary in order for the proposals to be effective that statutory whistle-blowing protection legislation be in place. The concern we have is that one size does not fit all and auditors in any given jurisdiction would have great difficulty to apply the proposals in the absence of the statutory whistle-blowing protection legislation. Hence, we consider the proposals may not result in the imposition of fair and equitable requirements on the part of auditors.



Under current practice, the auditor would render a modified opinion under ISA 705 "Modifications to the Opinion in the Independent Auditor's Report" in case issuing a "clean" audit opinion under ISA 700 "Forming an Opinion and Reporting on Financial Statements" is considered inappropriate. The auditor may resign from an engagement if deemed appropriate. The issuance of a modified opinion or resignation of auditor would draw the attention of regulators, who are empowered to make inquiries or investigations by laws and regulations, to take necessary further action if they consider appropriate, depending on the nature of the modification. We consider this practice is more appropriate than the proposed requirement and help the accountants to act in the public interest.

We are concerned that the proposed requirements could negatively impact on what should otherwise be a professional relationship between accountants and their clients. The proposed requirements may create the impression that a professional accountant is a "policeman" or "informant" and this may jeopardize the relationship between professional accountants and their clients and lead to mutual mistrust. This may indirectly affect the ability of auditors to provide a high quality of service and in turn unintentionally increase the professional risk that they bear.

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?

We consider there may be practical concerns in the case of a professional accountant providing professional services to an audit client of the firm or a network firm if that professional accountant has the same obligation as an auditor.

Although non-audit services may be provided to an audit client by the same firm or by a firm within the same network, those services are provided by the concerned firm in a different capacity and accordingly may be served by a different functional team of the firm. Those professional accountants are usually provided with limited information sufficient for performing their services. The professional accountants who provide the non-audit services may not discuss their service-related information with the auditor without consent by the client due to the usual "Chinese Wall" arrangement. Accordingly, those professional accountants who provide non-audit services may not have sufficient client information or have the same access to management, or those charged with governance, as the auditor to be able to fulfill the proposed requirements applicable to auditors. We therefore consider it is not appropriate for a professional accountant providing services to an audit client of the firm or a network firm to have the same obligations as an auditor.

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?

The proposals would require disclosure of the following matters by a professional accountant in public practice:

- When providing services to an audit client:
 - Suspected illegal acts that directly or indirectly affect the client's financial reporting; and
 - Suspected illegal acts the subject matter of which falls within the expertise of the professional accountant
- When providing services to a non-audit client:
 - Suspected illegal acts that relate to the subject matter of the professional services being provided by the professional accountant

In recognising the wide range of specialisations that professional accountants have, we believe it is unrealistic to expect that professional accountants are experts in matters relating to all professional accountancy services. Although professional accountants may share a similar core common body of knowledge in certain areas (for example, financial reporting), the expertise of any one professional accountant may differ considerably from other professional accountants; because of the wide range of highly specialized services that professional accountants provide to clients.

We appreciate that professional accountants should possess a background legal knowledge on discharging their responsibilities in engagements; however they are not, and should not be, expected to be legal specialists. We consider that professional accountants should not be expected to provide a "legal clearance" through the performance of their engagements.

We consider that the definition of a "suspected illegal act" may be subject to interpretation that may be wider than intended. One example is the simple case of overtime in excess of statutory hours of local workers in a subsidiary in another country can be a suspected illegal activity in that country. Under the proposal the auditor of the holding company in another country may need to disclose this suspected illegal act to the relevant authority even if it has no jurisdiction on labour or anything in that country. We consider such arrangement is potentially disproportionate and onerous. There are also concerns of confidentiality restrictions imposed by local laws which may prevent one from reporting to a holding company in another country.

Without necessarily agreeing to the proposed requirements and rights to professional accountants, we consider the disclosure by professional accountant in public practice providing services to clients (including audit and non-audit client) should be confined to a suspected illegal act in the professional accountant's own jurisdiction that relates solely to the subject matter of the professional services being provided by the professional accountant, and that a reasonable and informed third party would conclude the professional accountant should possess sufficient legal knowledge on the subject matter. In circumstances where the professional accountant has been specifically retained to provide services in dealing with a suspected illegal act especially under legal privilege (for example which may include forensic work), it would not be appropriate for the professional accountant to be under an obligation to report such a suspected illegal act unless otherwise required to do so by local laws.

- 8. 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 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 consider the role of a professional accountant in public practice providing services to a client that is not an audit client is more of a fiduciary nature towards the client and employer. We therefore consider that the 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 not be required to disclose the suspected illegal act to the entity's external auditor.

As mentioned in our response to question 3, we consider the guidance included in paragraph 140.7 of the existing Code to be sufficient in the meantime to assist a professional accountant to understand what is meant by acting in the public interest.

- 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?**

We agree in principle for the Code to afford a professional accountant providing professional services to a client that is not an audit client of the firm (or a network firm) the right to override confidentiality and disclose certain illegal acts to an appropriate authority, after considering all the facts and circumstances, in the public interest if the matter has not been appropriately addressed by the entity.



However, based on the same reasoning as in our response to question 2, we consider that the decision on whether to make such disclosure to the authority should rest within the discretion of the professional accountant and the Code should not impose on the professional accountant additional requirements in terms of whether they need to explain their approach and reasoning should they choose not to make such a disclosure. Consistent with our response in question 2, professional accountants will need to think carefully before exercising a discretionary right where there is no appropriate statutory whistle-blowing protection legislation in place, as the personal costs to them may outweigh any benefits achieved.

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?

Consistent with the reasoning in our response to Question 7, without necessarily agreeing to the proposed requirements and rights to professional accountants, we consider the suspected illegal acts to be disclosed, as referred to in question 9, should be confined to suspected illegal acts that relate solely to the subject matter of the professional services being provided by the professional accountant and in relation to which a reasonable and informed third party would conclude the professional accountant should possess sufficient legal knowledge on the subject matter.



Matters specific to professional accountants in business ("PAIB"s) (Section 360 of the Code)

11. Do respondents agree that a PAIB 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?

Our concerns as expressed in question 5 apply also to professional accountants in business. In addition, we note that many jurisdictions, including Hong Kong, do not require the person in charge of a company's finances to be a certified public accountant (or a "professional accountant"). If the effect of these proposals would give rise to companies viewing PAIBs akin to "policeman" or "informant", this would directly affect their competitiveness as compared with someone other than a professional accountant. There is also the possibility that, without appropriate statutory whistle-blowing protections in place, PAIBs, especially for those who are more senior and influential in society, who do not need an accounting qualification may terminate their professional accountant qualification in reaction to the potential effect of the proposals.

As the Code applies equally to PAIBs at all levels, and given our policy of converging with international pronouncements, we are not yet sure whether it might be appropriate for us to apply these proposals, if formalized to the Code, to junior staff, particularly in view of the fact that their CFO or Finance Director may not be a professional accountant.

We also consider it may not be equitable to impose requirements, to the extent proposed, to professional accountants where comparable requirements are absent for lawyers, engineers, medical practitioners and other professionals. The proposals may also discourage the next generation from entering the accounting profession, which could jeopardize the ongoing development and sustainability of the profession.

Accordingly, we have substantial concerns with the above-mentioned proposal, which would require a PAIB to disclose a suspected illegal act to the entity's external auditor, where he or she has doubts about the integrity of management.

12. Do respondents agree that a PAIB 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?

We agree in principle for the Code to afford the PAIBs the right, after considering all the facts and circumstances, to override confidentiality and disclose certain illegal acts to an appropriate authority.

However, based on the same reasoning as set out in our response to question 2, we consider that the decision on whether to make such a disclosure to an appropriate authority should rest within the professional accountant's discretion and the Code should not require the professional accountant to explain their decision on the exercise of that right. Consistent with our response in question 2, we consider that a professional accountant will need to think carefully about how and when to exercise a discretionary right, where they have no protection under the law from legal action. We consider there might be practical difficulties for professional accountants to exercise their discretionary right if they would likely need to bear personal liability for compromising their confidentiality obligation under an employment contract or under local laws and regulations.

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?

The proposals require disclosure of the following matters by a PAIB:

- Suspected illegal acts that directly or indirectly affect the employing organisation's financial reporting; and
- Suspected illegal acts the subject matter of which falls within the expertise of the professional accountant

Consistent with the reasoning in our response to Question 7, without necessarily agreeing on the proposed requirements and rights afforded to professional accountants, we consider the suspected illegal acts to be disclosed, as referred to in question 12, should be confined to those that relate solely to the employing organisation's financial reporting or, where professional accountants are working in other areas of business, those areas in relation to which a reasonable and informed third party would conclude the professional accountants should possess sufficient legal knowledge on the subject matter.



Other

- 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?**
- 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 the exceptional circumstances be described?**

The proposed provisions provide that in exceptional circumstances disclosure is not required or expected. Such exceptional circumstances would arise where a reasonable and informed third party would conclude the likely consequences of disclosure are so severe as to justify not disclosing. An example of such an exceptional circumstance would be threats to the physical safety of the professional accountant or others. Circumstances of a commercial nature, such as the loss of a client or income, would not constitute exceptional circumstances. The IESBA is of the view that commercial consequences to the professional accountant or others are not sufficient grounds to warrant justification for not disclosing.

We understand that the exceptional circumstances that warrant non-disclosure would need to pass the "reasonable and informed third party test" where physical safety was provided as an example of a legitimate exceptional circumstance. While we agree that physical safety is an obvious example of a legitimate exceptional circumstance for non-disclosure, it should not be viewed as the only legitimate exceptional circumstance for non-disclosure. We consider the legal liability and related legal expense to be borne by the professional accountant should also be legitimate considerations for non-disclosure and should also be quoted as examples for exceptional circumstances.

The proposals would also require the professional accountant to determine whether to terminate the professional relationship with the client (in the case of a professional accountant in public practice) or to resign from the employing organization (in the case of a PAIB) if the professional accountant determines not to disclose because exceptional circumstances exist. We understand that the laws and regulations of many jurisdictions do not require the person who takes charge of a company's finances to be a professional accountant. Possibly, some PAIBs may feel as if they would be obliged to cancel their professional accountant qualification, instead of resigning from the employing organization, to prevent them from being impacted by the proposed requirements.



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

We have substantial concerns with the proposed documentation requirements.

We understand the IESBA is of a view that maintaining the proposed documentation is in the interest of the professional accountant. However, we are mindful that such requirements may require a disproportionate amount of work from the professional accountant. Moreover, there may a possibility that the documentation could be subpoenaed and used against the professional accountant and the client. Without being afforded with statutory "whistle-blowing" protection, there may be practical difficulties for professional accountants to implement the proposed guidance. Furthermore, some of the documentation may be privileged because consultation with legal counsel may have taken place to determine whether an illegal act has occurred and the appropriate authority to report, especially if it is cross-border.

In the event that the IESBA were to adopt additional guidance (as distinct from requirements) for professional accountants when encountering suspected illegal acts, we would support the inclusion of something along the lines of the wording in paragraph 100.20 of the Code, which provides "[i]t may be in the best interests of the professional accountant to document the substance of the issue, the details of any discussions held, and the decisions made concerning that issue."

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?

Please refer to our responses to other questions in the Exposure Draft for comments on the existing section of the Code.

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?

As mentioned to our response to the above questions, we consider the proposed requirements have the potential to bring a significant negative and detrimental impact to not only professional accountants in public practice or those in business, but also to the business community as a whole.

For the reasons stated above, we believe the IESBA's impact analysis has not sufficiently considered the ramifications or costs of this proposal, nor the fundamental changes in the nature of the relationship that professional accountants in public practice may have with their clients and that PAIBs may have with their employers if this standard was to be adopted as proposed.

~ END ~