



Our Ref.: C/EC

17 September 2015

Ken Siong  
Technical Director  
International Ethics Standards Board for Accountants  
529 Fifth Avenue, 6th Floor  
New York, NY 10017  
The United States of America

Dear Sir,

**International Ethics Standard Board for Accountants Exposure Draft on Responding to Non-Compliance with Laws and Regulations**

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only body authorised by law to promulgate financial reporting, auditing and ethical standards for professional accountants in Hong Kong. We welcome the opportunity to provide you with our comments on this Exposure Draft (ED).

We support the principle that professional accountants have a responsibility to act in the public interest and recognize that the aim of the ED is to guide professional accountants in assessing the implications of suspected or identified non-compliance with laws and regulations (NOCLAR) and to determine an appropriate response.

We appreciate the effort the International Ethics Standard Board for Accountants (IESBA) made in revising the original proposals by considering the responses and inputs from various stakeholders across many jurisdictions. We welcome the alignment of the scope of laws and regulations with that of ISA 250 *Consideration of Laws and Regulations in an Audit of Financial Statements* under the new proposals. We also support the differential approach for the four categories of professional accountants when responding to suspected or identified NOCLAR.

The current proposals extend the professional accountant's current role in responding to suspected or identified NOCLAR that are deemed potentially substantially harmful to the wider public, in particular, to consider whether to disclose the matter to an appropriate authority even if disclosure is not required by law or regulation. Although the proposals have set out various subjective criteria and have introduced the third party test for assessing the need for, and the nature and extent of, further action, the lack of precise criteria and how various factors interrelate may still create an expectation that professional accountants are obliged to disclose NOCLAR to an appropriate authority. Accordingly, we suggest that further guidance or clarification on the level of threshold for taking further action would be helpful in order to facilitate consistent application of the proposed requirements.



Our responses to the questions raised in your Invitation to Comment are set out in the Appendix for your consideration.

If you have any questions regarding the matters raised in our comment letter, please contact Eky Liu, Associate Director, Standard Setting at [eky@hkicpa.org.hk](mailto:eky@hkicpa.org.hk).

Yours faithfully,

Chris Joy  
Executive Director

CJ/EL  
Encl.

### Detailed comments on IESBA ED on Responding to Non-Compliance with Laws and Regulations

#### General Matters

##### 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?**

The proposals have clearly set out the requirements that professional accountants should comply with applicable laws and regulations, including legal or regulatory provisions governing the reporting of identified or suspected NOCLAR to an appropriate authority, when responding to NOCLAR. We consider the guidance in the proposals support the implementation and application of the legal or regulatory requirement where law or regulation requires the reporting of identified or suspected NOCLAR to an appropriate authority.

##### 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 professional accountants in fulfilling their responsibility to act in the public interest in the circumstances?**

We consider the proposals, in overall, provide guidance for professional accountants in fulfilling their responsibility to act in the public interest in the circumstances where there is no legal or regulatory requirement to report identified or suspected NOCLAR to an appropriate authority. Having said that, in order to ensure consistent and appropriate application of the proposed requirements, we consider it would be helpful to provide clarification on the threshold for taking further action. Please refer to our response to Question 7 for detail of clarifications we suggested.

##### Question 3

**The Board invites comments from preparers (including those charged with governance (TCWG)), users of financial statements (including regulators and investors) and other respondents on the practical aspects of the proposals, particularly their impact on the relationship between:**

##### **(a) Auditors and audited entities**

We welcome the alignment of the scope of laws and regulations covered by the new proposals with that of ISA 250 *Consideration of Laws and Regulations in an Audit of Financial Statements* (ISA 250) given that auditors and their audited clients will be familiar with the standard that has been in place for several years.

In addition to their professional responsibilities under ISA 250, the current proposals also call for auditors to have regard for the wider public interest implications of

suspected or identified NOCLAR in terms of potentially substantial harm to stakeholders, and to determine whether further action is necessary. As explained further in our response to Question 7, there are some practical issues and uncertainties in determining the need of further action, including whether to disclose the matter to an appropriate authority. There is an ambiguity in the meaning of 'substantial harm' and there is also lack of clarity about who is a 'reasonable and informed third party' in the context of responding to NOCLAR. Although there is no obligation in the proposals for an auditor to report instances of NOCLAR to a relevant external authority, some of our constituents expressed the concern that the lack of precise criteria, including the absence of guidance as to how various factors interrelate with one another may result in inappropriate application of the proposed requirements and may even create an expectation that the auditors are obliged to disclose NOCLAR to an appropriate authority. This may result in clients becoming reluctant about providing full cooperation and complete information to their auditors.

In light of the above, we believe it is important to provide sufficient and clear guidance to assist auditors to determine when further action is needed in order to facilitate consistent application of the proposals and reduce potentially negative impact on the relationship between auditors and their clients.

**(b) Other professional accountants in public practice and their clients**

We consider that the proposals on guiding other professional accountants in public practice in responding to NOCLAR are appropriate. We do not foresee that the proposals would cause a significant impact on the relationship between other professional accountants in public practice and their clients.

**(c) PAIBs and their employing organizations.**

We agree with the overarching expectation that senior PAIBs are responsible for setting the right tone at the top and establishing an appropriate framework to prevent and deter NOCLAR within their organizations, for example, senior PAIBs could work with other management to establish compliance risks assessment and management or code of conduct. If this has been achieved we would not expect the proposals to cause a significant impact on the relationship between senior PAIBs and their employing organizations.

However, as with auditors, additional clarification in the threshold and criteria for senior PAIBs to determine whether further action is needed would be helpful. There is also lack of guidance on how the requirement to report suspected or identified NOCLAR to the external auditor would interrelate with the need to take any further action. We consider that if senior PAIBs become aware of the responses of the external auditors, they should take those into account when determining the need for their further action.

## **Specific Matters**

### **Question 4**

**Do respondents agree with the proposed objectives for all categories of professional accountants?**

We agree with the proposed objectives for all categories of professional accountants as indicated in paragraphs 225.3 and 360.3 of the ED.

### **Question 5**

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

We agree with the scope of laws and regulations covered by the proposed Sections 225 and 360 which have now been aligned with that of ISA 250.

### **Question 6**

**Do respondents agree with the differential approach among the four categories of professional accountants regarding responding to identified or suspected NOCLAR?**

We agree with the differential approach among the four categories of professional accountants regarding responding to identified or suspected NOCLAR based on their roles, levels of seniority and influence on and within the organisation. Please refer to our responses to Question 3 and Question 7 for our detailed comments on the proposed approach with respect to each category of professional accountants.

### **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?**

In general, we agree with the factors to consider in determining the need for, and the nature and extent of, further action.

Having said that, we consider it is vital to provide clear guidance to professional accountants when considering the need for further action given the consequences of taking action can potentially be significant.

In particular, when considering whether there is credible evidence of substantial harm to the public interest, we suggest the IESBA should further clarify the meaning of 'substantial harm' in the context of assessing whether further action is needed. The IESBA has included proposed guidance to explain that an act that causes substantial harm is one that results in serious adverse consequences to the public in financial or non-financial terms, however there is still some ambiguity about what constitutes 'serious adverse consequences'. To enhance consistent

application of the proposed requirements, we recommend that the IESBA provides practical examples to illustrate the level of 'substantial harm' that would warrant professional accountants taking further action. For instance, material misstatement of the entity's financial statements is an example of substantial harm to the entity as mentioned in paragraph 53 of the explanatory memorandum.

**(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?**

We consider that the application of the third party test provides an objective and rigorous assessment of the need for, and nature and extent of, further action. We note that such a reasonable and informed third party test has been imposed in other relevant parts of the Code as an objective assessment of whether compliance with the fundamental principles is compromised.

Some of our constituents considered that in the context of responding to NCOLAR, it is only fair that the reasonable and informed third party is of similar background and qualifications to the professional accountants involved, given the potentially specialized nature and complexity of the issues involved.

We understand that there have been different views and interpretations of who is a 'reasonable and informed third party' in the application of the third party test under the Code and we also note that the IESBA is currently developing guidance under the Review of Safeguards project to clarify what the concept means. We recommend that the IESBA considers the applicability and appropriateness of the proposed guidance in the context of NOCLAR.

In addition, it is not clear how the third party test would interrelate with the subjective criteria on assessing the need for further action. The current proposed wordings in the ED seem to suggest that the need for further action is only subject to the consideration of a list of subjective criteria. The third party test only applies to determine the nature and extent of further action after the professional accountant, based on professional judgement, concludes that further action is needed.

We consider it would be more appropriate to apply the third party test to assessing both the need for, and the nature and extent of, further action and suggest the IESBA clarifies this in the final standard.

**(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?**

We agree with the examples of possible courses of further action in the proposals and have no further suggestions for additional courses of action to specify in the Code.

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

We consider the list of factors to consider in determining whether to disclose the matter to an appropriate authority is comprehensive and relevant. In particular, the proposal now includes consideration of the existence of robust and credible protection from civil, criminal or professional liability or retaliation afforded by legislation or regulation. This has eased concerns about the lack of legal protection to whistleblowers in a jurisdiction where there is no legal or regulatory framework that requires such disclosures.

**Question 8**

**For professional accountants 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?**

For professional accountants in public practice providing services other than audits, we consider 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 is appropriate

**Question 9**

**Do respondents agree with the approach to documentation with respect to the four categories of professional accountants?**

We agree with the approach to documentation with respect to the four categories of professional accountants.

~ End ~