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USA

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### **Exposure Draft: Responding to Non-Compliance with Laws and Regulations**

Dear Mr. Siong,

BDO International Limited<sup>1</sup> is pleased to have the opportunity to comment on the International Ethics Standards Board for Accountants (IESBA or Board) exposure draft (ED) on non-compliance with laws and regulations. Following the previous consultation and the extensive stakeholder engagement, including the three roundtable events, we are of the view that the revised proposals are much improved and are more appropriate in terms of their interaction with jurisdictional confidentiality obligations and other local laws and responsibilities.

We do however, still believe that there is fundamental difficulty with PAs being held accountable for actions required by the ED that is in the 'public interest'. Although the concept of the Public Interest is critically important to the role a PA plays and the work they undertake, there is a lack of consensus and clarity around its definition. In turn, this may place unrealistic expectations on the PAs responsible under the ED, particularly in situations where governments and regulators have consciously not introduced reporting responsibilities, perhaps as a result of their own judgement of where the public interest lies.

Additionally, we believe that it is important that any action needed as a result of non-compliance with laws and regulations is recognised primarily as a management responsibility and, as such, the primary responsibility for action lies with senior boards of organisations, including those PAs who are part of these Boards. Any doubt that the auditor might rank equally in such responsibility might start to impinge upon the appearance of independence.

The following are our responses to the request for specific comments posed in the Explanatory Memorandum.

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## 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 guidance and its interrelationship with domestic law and regulation and support the Board's view that where there is a conflict, domestic law and regulation take precedence. This priority of law and regulation over compliance with the Code is important in respect of territories where their privacy laws would make such reporting unlawful.

Furthermore, we believe that matters of reporting to the appropriate authority should be reserved for local laws and regulation and the Code should not set out to establish additional reporting responsibilities. It is within the power of IESBA to afford protection to the PA in respect of disciplinary proceedings brought by Member organisations for breach of confidentiality but IESBA does not have the power to protect a PA from civil or criminal action where a statutory duty to report does not exist in local law and regulation. BDO would prefer to see it made clearer in the guidance that no duty to report exists where there is no legal protection afforded the PA in making an external report as this could lead to unintended consequences, where users of the financial statements could challenge the PA for concluding that reporting the matter was or was not a reasonable position.

- 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?**

In general, we do believe the proposals will be helpful to PAs in fulfilling their responsibilities. However, we do not consider the use of the term 'public interest' to be particularly helpful. The profession as a whole has had limited success in defining what public interest means in this context and has only managed it in terms of defining PIEs and non-PIEs, a distinction the Board has purposefully not adopted. We question the appropriateness of requiring individual PAs to assess what is in the public interest as opposed to using the benchmark of integrity and professional behaviour, which are well established and understood principles.

Furthermore, where governments and regulators have not defined statutory reporting requirements, the presumption should be they have found no public interest to protect in this regard. Before a PA breaches confidentiality to the client, they should be required to have good cause to rebut this presumption.

- 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;**

Where there is a statutory duty to disclose to the regulator, there is unlikely to be an impact on the relationship between the auditor and the audit client. However, there is a concern that, as currently drafted, the Code exceeds the requirements of ISA 250 in that it seeks to establish a duty to report to a regulator in circumstances that the ISA recognises only a right to report where there is a material effect on the financial statements. This raises a number of concerns:

- By making the auditor responsible for reporting matters to the regulator in circumstances where TCWG have not reported them, without reference to the materiality of the effect on the financial statements, or in circumstances where there is no statutory duty to report, a responsibility is placed on the auditor akin to supervision or management that could have an adverse effect on the perception of the auditor's independence. The auditor's primary responsibility is to report the matter of NOCLAR to the management and TCWG and request they inform the Regulator.
- It should not be the PA's responsibility to assess what is in the public interest absent a statutory duty to report, it is the responsibility of the government and regulator to

establish laws and regulations, including reporting requirements to determine what is meant by public interest, in the context of specific regulations.

- The existing fundamental principles provide sufficient guidance to the auditor in assessing whether they can continue to act and in most jurisdictions legislation affords them the right on resignation to state their reasons. Furthermore, ISA 250 already provides guidance to the auditor when they are concerned about the integrity of management and TCWG.

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

Although we are broadly supportive of the proposed guidance, there should be clarification of the extent of the PA's responsibility to investigate past or potential non-compliance, particularly in circumstances where that knowledge is ancillary/incidental to the service being provided. There may also be practical issues for PAs providing non-assurance services to non-audit clients gaining access to senior PAIBs or the auditor. It should be made clear in the guidance that their duty to report applies only where it is practical for them to do so.

Furthermore, there should be an exemption for those PAs acting as forensic accountants, in circumstances where privilege does not apply. In these cases it is generally TCWG that have appointed a forensic accountant to investigate and in those circumstances it should be recognised that reporting to TCWG is sufficient to satisfy the PA's professional duty. If this is not put in place, then management may be dissuaded from commissioning such investigations in the first place, which in itself might be considered to be against the public interest.

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

Although broadly supportive of the proposed guidance, more emphasis should be placed on the responsibilities of those PAs acting in a senior board capacity who should have the primary responsibility, by virtue of their position, to protect the public interest from non-compliance with laws and regulations (i.e. their responsibility is higher than that of the external auditor and any other PA whether external or internal.)

To the extent that non-compliance could be material to the financial statements, we support the Board's view that all breaches should be reported to the external auditor, even in circumstances where the breaches have been resolved, mitigated or rectified, in line with ISA 250. However, where the breach is not likely to have a material effect on the financial statements, we see no reason for requiring a report to be made to the external auditor where the matter has been resolved, mitigated or rectified.

## **Specific Matters**

**4. Do respondents agree with the proposed objectives for all categories of PAs?**

We are supportive of IESBA's objective to provide guidance to PAs in all spheres on how to apply the fundamental principles and the competing interest between acting honestly and with integrity in not turning a blind eye, and the duty of confidentiality to one's client or employer.

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

Although broadly supportive of the approach at codifying reporting requirements, BDO would caution the Board not to impose more stringent reporting requirements than are required by the local law and regulations. Furthermore, there are some examples on the list that go beyond the current requirements for PAs, even an auditor, to report to regulators, such as environmental and public health and safety where a right to report may exist but not a statutory duty and are arguably outside the scope of a PA's skill set or knowledge.

There also needs to be more guidance on what is meant by 'credible evidence of substantial harm', when there is merely a right (not a duty) to report. For example, does a PA who works in a senior position within a network rail company who discovers that the proposed rail maintenance plans have been delayed, satisfy his or her responsibility to report if the matter is reported to

TCWG. If no action was taken by TCWG would this constitute credible evidence of substantial harm requiring the matter to be reported to an appropriate regulator, or would further damage reports be required? At what point is the PA in possession of credible evidence?

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

We agree that the responsibility to report should be less onerous for those that hold more junior positions, whether that be in an organisation or by virtue of only providing specific non-investigative services. These individuals are less likely to have access to information regarding past or potential breaches and less able to obtain corroborative information to enable them to assess whether substantial harm could result.

However, we consider that it should be clear that a senior PAIB has the ultimate responsibility for compliance with laws and regulations. As currently drafted, there appears to be no distinction between the responsibility of the senior PAIB and external auditors.

**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?**

Although broadly supportive of the guidance, we question whether the threshold of credible evidence of substantial harm set in respect of the auditor and senior PAIBs should be the same. There is a danger that the lack of distinction between an auditor and senior management could impact on the perception of the auditor's independence. Furthermore, a senior PAIB should, by virtue of his or her position, have a more stringent responsibility to the Regulator.

Moreover, although 'substantial harm' is a recognised term in the US it is not a universally recognised benchmark. We believe that more guidance is needed to help PAs assess what would amount to 'credible evidence of substantial harm'.

**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?**

The independent third party test is a tried and tested approach, so BDO considers this to be an effective benchmark.

**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?**

BDO would caution against the proposal that places emphasis on reporting to the regulator when there is no statutory duty to do so and, as such, no statutory protection. This may be suitable for senior PAIBs, who hold a fiduciary duty to act in the interest of the company and as such the public interest but this could create an unrealistic public expectation of the responsibilities of other PAs.

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

Although we are broadly supportive, it should be made clear that the list of factors does not replace the exercise of professional judgement. Overriding the list of factors should be whether or not there is a credible and robust protection afforded to the PAs by legislation and regulation, where no duty to report exists.

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?

We are generally supportive of this, provided the Code recognises that cross border reporting may not be feasible, being constrained by local privacy laws, and that it not regard failure to report in these circumstances as a failure to act appropriately in a jurisdiction whose laws would allow or require reporting.

9. Do respondents agree with the approach to documentation with respect to the four categories of PAs?

We support the documentation requirements of the Code.

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We appreciate the opportunity to comment on the Exposure Draft and hope that our comments and suggestions will be helpful to you in your deliberations.

Please contact me should you wish to discuss any of these comments.

Yours sincerely,  
BDO International Limited

Wayne Kolins  
Global Head of Audit and Accounting