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Dear Ken

Exposure Draft Responding to Non - Compliance with Laws and Regulations

CPA Australia welcomes the opportunity to respond to the above Exposure Draft. CPA Australia represents the diverse interests of more than 150,000 members in 120 countries. Our vision is to make CPA Australia the global accountancy designation for strategic business leaders. We make this submission on behalf of our members and in the broader public interest.

General Comments

We welcome the further development of the proposed framework and the shift away from the imposition of a requirement on any professional accountant (PA) to report a suspected non-compliance with laws and regulations (NOCLAR) to an external authority.

The risk for the development of the Code and the profession remains that guidance on how to deal with NOCLAR may be seen as a prescription or a requirement by the profession's stakeholders (including regulators) and some of its members.

Consequently, and as we mentioned in our previous submission, this may change the status of professional accountants from trusted advisors and enablers of improved legal compliance and ethical behaviour by their clients and employers.

We are of the view that the disclosure of confidential information without the consent of the client or employer remains a breach of the fundamental principle of confidentiality, though it can be an appropriate disclosure in circumstances described in paragraph 140.7 of the Code. Therefore, we do not agree with the statement made in paragraphs 225.29, 225.45, 360.28 and 360.34 that disclosure 'would not be considered a breach of the duty of confidentiality under Section 140 of this Code', when it clearly is.

Paragraph 140.7 refers to circumstances when 'disclosure may be appropriate' and we think the description of 'appropriate disclosure' is more accurate and should be used instead.

We also are of the view that the proposed part (iv) of paragraph 140.7 should refer to the responsibility to act in the public interest and we suggest it states: To comply with technical, ethical and professional standards and the responsibility to act in the public interest.

These proposals do not stand alone but are part of the Code and its overall framework. We thus encourage the Board to ensure that the comments provided by respondents are considered in that context and are not addressed independently of the other content of the Code in the proposed sections

225 and 360. For example, compliance with laws and regulations, as well as technical and professional standards are included in the fundamental principles. We are of the view that there is no need to reiterate them as extensively as currently done in the exposure draft, so as to avoid increased volume, complexity and confusion.

Specific Comments

- 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 Code clearly states the requirement to comply with law or regulation and this requirement is contained in the principles of professional behaviour and professional competence and due care. We are of the view that restating this requirement is not necessary or desirable as this may have adverse consequences. For example, it may be perceived that compliance with laws and regulations is not fundamental when not explicitly emphasised or mentioned. Further, the objective of this project is not to ensure that PAs comply with legal or regulatory disclosure requirements but to provide guidance when such requirement does not exist.

- 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?**

The difficulty with the proposed guidance remains in the existing coverage of public interest in the Code, which states in paragraph 100.1: 'In acting in the public interest, a professional accountant shall observe and comply with this Code. If a professional accountant is prohibited from complying with certain parts of this Code by law or regulation, the Member shall comply with all other parts of this Code'.

However, the proposed guidance emphasises the dilemma professional accountants could face and does not provide any actual guidance in resolving it. It requires professional accountants to consider non-compliance with the fundamental principle of confidentiality, when not required by law or regulation, in order to act in the public interest.

While we find the current proposals of some value, we question how they are going to assist professional accountants to deal with the real dilemma of choosing between client confidentiality and a public interest disclosure. We are of the view that this is a determination that will be based on moral and professional judgement, which the proposed guidance does not and cannot provide. The proposed guidance outlines a possible process, which may be appropriate in some, arguably ideal, circumstances and contexts.

- 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.**

We support the disclosure of confidential information to an appropriate authority but remain convinced that such a disclosure should be a legal requirement that affords appropriate protection. As we mentioned in our submission to the previous consultation on this project, we understand that our members play an important role in educating their clients and employers to improve their legal compliance and ethical behaviour. They also are fundamental in introducing

systemic changes to reduce risks of illegal activities. We are unclear about the impact of the revised proposals on our members' ability to continue to undertake these roles.

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

We think that the proposed guidance introduces a different understanding of public interest than that already in existence in the Code. This may create more confusion than already exists around the concept of the public interest. As mentioned in our response to question 2, the Code states that: 'In acting in the public interest, a professional accountant shall observe and comply with this Code' and the Code's foundation is its fundamental principles. However, objective (c) of paragraph 225.3 of the proposed guidance states: 'To take such further action as may be needed in the public interest'. If compliance with the Code is acting in the public interest, it is not clear what further action may be needed or expected by professional accountants to act in the public interest.

Paragraph 225.4 explains what constitutes the public interest and states the facts and circumstances of the non-compliance or suspected non-compliance as a factor. We believe that the impact and consequences of illegal or suspected illegal activity affects the public interest in its broad sense, rather than the facts and circumstances of the non-compliance or suspected non-compliance. We also think that our view is better aligned with the remaining proposals that focus on the consequences of the NOCLAR (paragraph 225.7).

Further, in relation to paragraph 225.4(b), it is possible that the consequences may be neither immediate nor ongoing. Severe and other consequences may also arise in the medium to long term.

It is also not clear why the principles of integrity and professional behaviour were selected for inclusion in objective (a) of paragraph 225.3. We think there is a fundamental difference between the behaviour of professional accountants, which is what the Code's principles are about, and that of their clients or employers, something that is addressed in paragraph 100.1 and section 210 of the Code.

Further, we urge the Board to consider how the proposals interact with section 210, which asks professional accountants to terminate the professional relationship, while paragraph 225.30 states that withdrawing from the engagement is not adequate.

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

We broadly agree with the scope of laws and regulations in the proposal. We also suggest that the Board considers as examples the inclusion of company or corporate law and occupational or work health and safety laws. Further, the overall focus of the proposal is on clients and employers who exist in one jurisdiction and does not take into consideration incongruent legal requirements between different jurisdictions and laws and regulations which have extra-territorial coverage. We urge the Board to consider the complexities that these issues create and provide some guidance.

The terminology in relation to the stakeholders and the public requires some attention. In paragraph 225.7 'employees' are included as examples of the wider public and paragraph 225.8 refers to the client's 'stakeholders or the wider public'. Paragraph 225.4 also refers to the wider public. Employees are generally considered internal stakeholders and thus not part of the wider public, while the wider public is generally considered a stakeholder. It may be more appropriate and clearer to refer to other stakeholders instead of wider public, which will refer to any groups of people that are affected by the client or employer, or refer to 'community' or 'general public' as is the norm in stakeholder terminology.

Paragraph 225.9 states: 'It is the responsibility of the client's management, with the oversight of those charged with governance, to ensure that the client's business activities are conducted in

accordance with laws and regulations. It is also the responsibility of management and those charged with governance to identify and address any non-compliance with laws and regulations by the client or by those charged with governance, management or employees of the client'. Given the global nature of the Code, and the varied corporate governance approaches, we are of the view that management and those charged with governance should be mentioned as responsible, rather than management with the oversight of those charged with governance.

Paragraphs 225.13 and 225.36 state: 'The information conveyed by the professional accountant may prompt management or those charged with governance to investigate the matter'. We are not sure of the rationale and appropriateness of this statement. If the Board believes that the professional accountant should do the prompting, then it should express this view. Otherwise, we think that the possible or likely desirable consequences of actions of those who are not required to comply with the Code are better not addressed in it.

Paragraph 225.14 and 225.37 refer to 'an appropriate legal or adjudicative body'. A legal body in many jurisdictions may refer to a law firm or society. For example, in Australia the Australian Law Council is described as Australia's peak legal body. We encourage the Board to consider the terms used and the potential translation issues. These paragraphs also state: 'Depending on the nature and significance of the matter, the professional accountant may consult on a confidential basis with others within the firm, a network firm, a relevant professional body, or legal counsel'. We are of the view that the PA should consult with 'the' network and 'the' relevant professional body rather than any network or professional body.

The statement 'Disclosure would be precluded if it would be contrary to law or regulation' is included in paragraphs 225.27 and 360.26. As mentioned earlier, our view is that this statement expresses a fundamental principle and foundation of the Code and we do not think it needs to be restated.

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

We agree with the differential approach adopted, however we are also mindful of the potential risk in creating or encouraging the perception that there are different classes of PAs with different duties and responsibilities. The adopted approach may also be perceived to be at odds with the assumed position of the Board that the Code is and remains to be principles and professional judgement based.

The adopted approach may also create precedence for differential coverage in the Code for other issues and while this may not necessarily be a negative development, we would encourage the Board to explore and appreciate its potential consequences.

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?

Overall, we agree with the factors to consider in determining the need for, and the nature and extent of further action. However, we urge the Board to consider the following issues:

- Behaviour may not be pervasive and yet cause substantial harm to a stakeholder group or a number of stakeholder groups.
- The issue of substantial harm needs to be developed further. For example, there may be substantial (financial) harm but to one creditor only. Would the Board consider this an instance of substantial harm? More broadly, would the Board expect a professional

accountant to consider substantial harm towards stakeholder groups or individuals from each stakeholder group?

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?

Overall, we agree with the employment of the third party test, as we are of the view that it helps professional accountants to potentially overcome some perceptual distortions and assess the situation more objectively. We are not sure of the inclusion of the word 'appropriately' in the public interest in paragraphs 225.25 and 360.24, as we cannot envisage how one can act in the public interest inappropriately.

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?

Overall, we agree with the two examples of further actions in relation to audits of financial statements and senior PAIBs. However, it is possible that disclosure to an external authority and withdrawal from the engagement or resignation from the employer may be undertaken at the same time.

In relation to senior PAIBs, we are of the view that the actual order of events is unlikely to reflect the process developed in the guidance. It is also not uncommon for many senior PAIBs to be dismissed from their employment after they start 'addressing the matter'.

Given the potential for retaliation and harm, we insist that the determination as to what further action is appropriate can only be made by the professional accountant in context.

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

We appreciate the difficulty faced by professional accountants worldwide in addressing suspected non-compliance with laws and regulations and the multitude of factors that they would need to consider in each specific case. The list of factors provided is based on ideal type contexts, which we suspect would not be found in many actual contexts and cases, particularly in relation to the existence of robust and credible protection from liability and retaliation, even when legislation that affords it is in place.

This reality underlies our view that the most effective way to deal with client or employer non-compliance with laws and regulations is for law makers to compel and enable professional accountants to disclose to a specific authority.

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 agree with the requirement that a PA considers whether to communicate the matter to the network firm where the client is also an audit client of the network firm so that the engagement partner becomes informed. However, this raises the issue as to whether such a communication is with an external entity and has implications for confidentiality, since the principle of confidentiality imposes an obligation to refrain from disclosures outside the firm. So we encourage the Board to consider and provide guidance in relation to network wide disclosures and whether they would be considered disclosures to external entities.

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

We agree that adequate documentation is necessary for all PAs. However, we are concerned that the Code and the International Standards on Auditing (ISAs) are addressing some of the same issues and appear to have started an ongoing and potentially perpetual realignment exercise.

In addition, we do not think it is necessary for the Code to restate the ISAs requirements, as PAs are required to comply with applicable technical and professional standards. This inclusion creates a new precedence in the Code (excluding section 290), which is likely to add length and complexity and may not achieve any positive outcomes.

If you require further information on our views expressed in this submission, please contact Dr Eva Tsahuridu, CPA Australia by email at eva.tsahuridu@cpaaustralia.com.au.

Yours sincerely

A handwritten signature in black ink, appearing to be 'Stuart Dignam', with a long horizontal stroke extending to the right.

Stuart Dignam
General Manager, External Positioning