September 30, 2015

Ref.: SEC/083/15 - DN

Ken Siong
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International Ethics Standards Board **(IESBA)**
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Dear Mr. Siong,

We, the Ibracon – Instituto dos Auditores Independentes do Brasil (Institute of Independent Auditors of Brazil), appreciate and thank you for the opportunity to comment on the Exposure Draft of "*Responding to Non-Compliance with Laws and Regulations"* as developed by the International Ethics Standards Board (IESBA).

In general, we propose to express broad support for the redrafted ED, in response to the public calls for a more transparent business environment. We note, however, that the proposed changes to the Code of Ethics will have a significant impact in Brazil, and most likely, in other jurisdictions, not only for accountants and auditors but potentially also on the regulatory and judicial arenas. For this reason, we highlight that the timeframe established by the Board to collect comments on the ED seemed to be, in our view, very tight given the importance and potential impact of this matter.

We have provided our comments described below considering the potential impact for the profession in Brazil. Most of them are directly or indirectly related to the questions where the Board requested comments but are not intended to respond to each specific question set out in the ED. Our recommendations and proposed changes are listed below:

1) Public interest interpretation

Paragraph 225.4 states***: "... What constitutes the public interest will depend on:***
(a) The facts and circumstances of the non-compliance or suspected non-compliance; and
(b) The nature and extent of the immediate or ongoing consequences to the client, investors, creditors, employees or the wider public."

Paragraph 225.17 states***: "…. If management and, where appropriate, those charged with governance agree that non-compliance has occurred or may occur, the professional accountant shall prompt them to take appropriate and timely actions, if they have not already done so, to:***
(c) Disclose the matter to an appropriate authority where required by law or regulation or where considered necessary in the public interest."

We selected the paragraphs above to highlight our concern regarding the use of the expression "Public Interest" in this document. Even though the Board recognized some of the concerns raised in the previous ED, it has continued to use such concept throughout the proposed regulation as a threshold for the determination of further action by PAs.

The idea of public interest may have different meanings in common law and Roman law jurisdictions. While in common law countries, the public interest frequently indicates the "interest of the people", or "the general population", in Roman law countries the public interest is deemed to represent an idealistic principle that should drive all actions of the State. From this perspective, the concept of public interest resembles the aspiration for justice in all actions of the state. Justice, however, is a subjective concept by nature. It can only be explained with reference to other principles that are

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able to express only a certain conception of justice. We may think about justice as an aspiration for equal treatment, charity, the rule of law, and many other expressions of social value that could indistinctly express the ideal of justice, depending on a given time, place and on the views of the interpreter. The public interest, like justice, is a concept that relies fundamentally on subjective assessments. It may vary from place to place, from person to person.

The proposed wording for section 225.6 provides examples of the laws and regulations sought by the new rules. It becomes clear that the rules do not target "any" laws and regulations, but only those that can somehow affect the wider public. From a Brazilian law perspective, we must note that all the examples that are mentioned would be classified within the concept of "public law". The differentiation between public and private law sits on the basis of the Roman law system and carries with it important implications in terms of the specific regimes applicable to each of such branches of law.

Public law is generally related to the affairs of the State, including the relations between the State, its agents (public servants) and private companies or individuals. One of the core principles of public law is the *supremacy of the public interest*. According to this principle, the public interest is inalienable, and cannot be put aside for any reason whatsoever. It means that the State shall always pursue the public interest, and no state action will be legitimate if motivated by an interest incompatible with the public interest, either it being of a private nature or otherwise.

Again, a public agent will often be able to choose amongst several alternate actions equally compatible with the public interest. In fact, by being and ideal aspiration, the definition of the alternative that would serve the public interest best depends on a subjective assessment to be made by the public agent. It will ultimately reflect the exercise of discretion. In other words, often times more than one action will be indistinctly compatible with the public interest. The choice between one and another will mostly rely on authority instead on the essence of the action chosen.

All the examples mentioned in the proposed section 225.6 form part of what in a Roman law system would fall in the aforementioned definition of "public law". In all these cases, the public interest is the veritable cause of existence of any such laws and regulations. In our view, using the public interest as the standard that could require the PA to disclose a NOCLAR to the relevant public authority could trigger undesirable confusion and expose the PAs further beyond the intended objective of the public accounting profession and the principles under which the profession itself was built.

As noted, the public interest is inalienable. It cannot be waived, by definition. Therefore, assuming that the PA would be required to consider informing the authorities about a NOCLAR whenever the "public interest" so requires, it becomes very difficult to imagine a situation where the PA would conclude that informing to authorities is not necessary. In practice, the standard could be seen in our jurisdiction as the elimination of the duty of confidentiality of the PA whenever the matter at hand relates to a potential antibribery, environmental protection, taxation issue, etc. The public interest is the underlying value in all these laws and regulations.

Taking into account that the institutional environment may become more litigious for independent auditors in Brazil, the use of an idea such as "the public interest" to determine whether further action is needed would significantly increase the burden over the profession.

2) Non-compliance with law and regulations (NOCLAR) involving a party other than the client

Paragraph 225.8 states***: "…This section does not address: .....(c) Non-compliance with laws and regulations committed by persons other than the client, those charged with governance, management or employees of the client. The professional accountant may nevertheless find the guidance in this section helpful in considering how to respond in these situations".***

This statement does not seem to be sufficiently clear, in our view, for certain practical situations. There are many services, including buy-side due diligence, where a professional accountant may come across situations involving NOCLAR at another organization, such as a client's target. In cases where the other party is not a client of the firm, the firm will not have a direct relationship with that other party and no (or little) access to management nor the ability to address the matter in accordance with the proposals.

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The challenge arises where the firm provides services for client A (e.g. buy-side due diligence) and comes across a situation involving NOCLAR at the target which is also client of the same firm (client B – in this example, a target of client A), which could be an audit client or a non-audit client. In these cases, the firm (or another firm of the network) does have a direct (contractual) relationship with entity B, however:

The proposal seems to indicate:

- If A is an audit client of the firm and a NOCLAR is identified at A, then the professional accountant shall inform the audit partner of A (225.39)
- If A is an audit client of a network firm and a NOCLAR is identified at A, the professional accountant shall *consider* informing the audit partner of A (225.40)

In none of these provisions is clear what the expectation is if the non-compliance with law and regulations relates to client B. Paragraph 225.8 could be read that no actions are required by the firm. On the other hand, it may be understood that a third party might expect communication at least in the circumstances where the firm or network is also the auditor of B, subject as always to compliance with local laws and regulations.). Given the potential confusion around this type of situation, we are of the opinion that better clarification is required.

3) Professional accountants may consider consulting with others even in a confidential basis

Paragraph 225.14 states: **…..”** ***The professional accountant is expected to apply knowledge, judgment and expertise, but is not expected to have detailed knowledge of laws and regulations beyond that which is required for the audit. Whether an act constitutes actual non-compliance is ultimately a matter for determination by an appropriate legal or adjudicative body. 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.”***

This is a very important statement. Professional accountants are not expected to have detailed knowledge of law or regulation about the matters except for those required for its audit. However, since professional accountants shall obtain and understanding of the matter taking into account the nature of the act and the circumstances in which it has occurred to conclude whether such matter is considered a NOCLAR. As a result, in several instances professional accountants need to assess in more depth the matter to reach out to a better understanding of the facts and circumstances. The evaluation if a specific matter requires a consultation with others is a question of professional judgment and then we are of the opinion that this Board should provide additional guidance and clarification on the circumstances in which the PA should consult others and what exactly means the expression “on a confidential basis”, especially when the consultation is made to a professional body.

Regarding paragraphs 225.26 and 225.37 which also describe situations involving consultations with others outside the firm, there is an indication that PAs should evaluate the need for consulting, amongst others, the professional bodies or regulators. We would recommend the Board to take into account the various legal and regulatory requirements in place in different jurisdictions, which could prohibit such consultations. Where the Code is adopted directly into Law, consideration would need to be made in relation to conflicts between them. Where the Code is not adopted into Law, the law would prevail. With the objective of avoiding any potential conflict, the Board should consider an amendment in both paragraphs mentioning “unless such consultation is prohibited under law or regulation”.

4) Professional accountants may consider inform the client of the need for disclosing a specific matter to an appropriate authority

Paragraph 225.29 states: **…..”** ***If the professional accountant determines that disclosure of the matter to an appropriate authority is an appropriate course of action in the circumstances, this will not be considered a breach of the duty of confidentiality under Section 140 of this Code. When making such disclosure, the professional accountant shall act in good faith and exercise caution when making statements and assertions. The professional accountant shall also consider whether it is appropriate to inform the client of the professional accountant’s intentions before disclosing the matter.”***

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The Board should consider providing additional guidance and clarification for the professional accountants in order to allow a better understanding of the circumstances that would be considered appropriate informing the client of the PA´s intention in communicating a specific matter to the appropriate authority and also consider whether such communication to the client in advance could have any influence that could jeopardize the PA´s ability to clearly describe a NONCLAR. Therefore we recommend the Board to analyze the actual benefit of such communication to the clients.

5) Clarification related to the meaning of "non-financial terms" and "substantial harm"

Paragraph 225.21 states: **….."** ***Whether further action is needed, and the nature and extent of it, will depend on various factors, including:***

• The legal and regulatory framework.
• The appropriateness and timeliness of the response of management and, where applicable, those charged with governance.
• The urgency of the matter.
• The pervasiveness of the matter throughout the client.
• Whether the professional accountant continues to have confidence in the integrity of management and, where applicable, those charged with governance.
• Whether the non-compliance or suspected non-compliance is likely to recur.
• Whether there is credible evidence of actual or potential substantial harm to the interests of the entity, investors, creditors, employees or the wider public. An act that causes substantial harm is one that results in serious adverse consequences to any of these parties in financial or non-financial terms.

This bullet describes that further actions may be required when PAs identify an act that causes substantial harm that could result, amongst others, in serious consequences in financial and non-financial terms to the interests of the entity. This may appear to impose a wider scope other than what is defined in the standards and rules of an audit of financial statements and may raise a concern on how to ensure that everything was captured or taken into account. Moreover could impose to professional accountants the responsibility to exercise judgment beyond what is the professional accountants´ expertise and what is required for them to perform an audit.

The IESBA paper suggests that the vagueness of the concept of public interest could be overcome by the utilization of the standards applicable for the legal profession in certain matters before the SEC. As the text notes, however, the referred rules would authorize, but not require, US lawyers to report situations of NOCLAR they may come across.

It must be noted, however, that the substantial harm standard is present only in section 225.21. And even so it is only 1 of the standards to be used by the auditor. There are 6 other situations where the PA would be equally required to report the NOCLAR.

Therefore, use of the concept of "substantial harm" may not be sufficient to eliminate the uncertainties around the concept of "public interest". It should be noted that the proposed rules use the idea of public interest in several occasions, but only once qualifies the reporting consideration to the existence of a "substantial harm". And even so concurrently with other 6 criteria that are equally vague.

In addition, a substantial harm is vaguely defined as "one that results in serious adverse consequences to any of these parties in financial or non-financial terms". In our view, it would be extremely difficult, if at all possible, for an auditor to determine what would be a "serious adverse consequence" of a "non-financial" nature for the parties at stake. The proposed rules do not provide practical guidance to solve this type of question. Additionally, we recommend the Board to consider providing a better guidance and clarification in relation to the meaning of "non-financial terms".

6) Forensics services

Paragraph 225.44 states: **….."** ***In considering whether to disclose outside the client, relevant factors to take into account include:***
• Whether doing so would be contrary to law or regulation.

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• Whether the terms or nature of the engagement precludes disclosure of information about the client to third parties, such as where legal privilege exists which extends to the professional accountant.
• Whether there are restrictions about disclosure imposed by a regulatory agency or prosecutor (for example, to avoid tipping-off) in an ongoing investigation into the non-compliance or suspected non-compliance.

We recognize that proposed 225.44 states that a factor to consider in evaluating any need to disclose a matter outside the client is whether legal privilege exists. In practice, however, most forensic work performed in the accountancy firms is not performed by lawyers or under legal privilege and so this consideration would not preclude professional accountants from considering disclosing NOCLAR outside the client. The bullet refers broadly to "whether the terms or nature of the engagement precludes disclosure", which might be argued to apply to forensic work (i.e., the nature of that work would preclude disclosure to be effective). However, the example of legal privilege leaves the impression that the bullet may be limited to circumstances when there is a legal basis to evidence the "preclusion".

If forensic work is not explicitly exempted, we believe that companies will be dissuaded from hiring professional accountants to perform this type of work. This may potentially lead to less qualified/specialized professionals being asked to perform the work, and hinder the ability of the company to deal with an issue appropriately.

We strongly recommend for this reason that where a client hires a professional accountant to conduct forensic services to help it to investigate a known or suspected fraud or other NOCLAR that the only responsibility is to report to management or those charged with governance and that the code clarifies that the responsibility for further action lies solely with the client.

Please contact us if you wish to discuss the contents of this letter.

Yours sincerely,

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