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**Our Ref: PSC/PSD/TS/ED07/2015**

Thursday, 27 August 2015

Ken Siong
Technical Director
International Ethics Standards Board for Accountants
International Federation of Accountants
529 5th Avenue, New York
USA

Email: kensiong@ethicsboard.org

Dear Ken,

***RE: Exposure Draft ED - Responding to Non-Compliance with Laws and Regulations (NOCLAR)***

The Institute of Certified Public Accountants of Kenya (ICPAK) welcomes the opportunity to comment on the Exposure Draft ED - Responding to Non-Compliance with Laws and Regulations issued by the International Ethics Standards Board for Accountants (IESBA).

ICPAK support the Board's initiative that it is in the public interest for there to be robust mechanisms to effectively address serious instances of NOCLAR perpetrated by entities and individuals in relation to accounting that affect the financial statements they publicize or could otherwise have a serious public interest connotation. We also note significant improvement over the last Exposure Draft - Responding to a Suspected Illegal Act issued in August 2012.

We believe that IESBA has thoughtfully categorised professional accountants in these four groups (Professional Accountants Performing Audits of Financial Statements, Professional Accountants in Public Practice Providing Professional Services Other than Audits of Financial Statements, Senior Professional Accountants in Business, and Other Professional Accountants in Business) and addressed the responsibilities of each of these groups.

However, we are concerned that the revised proposals retain a de-facto requirement for the auditor to disclose in certain circumstances. We remain firmly of the opinion that the legislator in a particular jurisdiction – and not the IESBA – should address the specific situations where a PA or an auditor may break client confidentiality. We do not support the proposals in paragraphs 225.24 and 225.27 whereby under the IESBA Code an auditor might disclose a matter to an appropriate authority when there is no legal or regulatory requirement to do so.

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We believe that the IESBA Code should mirror ISA 250 and therefore not foresee auditors breaking client confidentiality unless this is specifically provided for within the applicable laws and regulations of their particular jurisdiction. We are also concerned that the proposals, if adopted, would increase the stringency of the extant Code in regard to instances of NOCLAR of which a PA may become aware. This portends a risk of unnecessarily extending the auditor's work effort, and documentation requirements beyond as is already required by ISA 250, potentially resulting in additional costs to the audit and, in some cases, potential delay to audit completion.

If the Board decide to proceed with the proposals, our comments and detailed responses to the questions for respondents as set out in the consultation paper are detailed hereafter.

Should you require any additional information, please contact the undersigned via icpak@icpak.com or nixonomindi@icpak.com.

Yours Sincerely,

Nixon Omindi
**For Professional Standards Committee**

**Questions for Respondents**

***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 do not see any need for the IESBA Code to provide implementation or application assistance for the profession in different jurisdictions. In Kenya, it is illegal for auditors to break client confidentiality, other than as explicitly provided in law. In our view, the IESBA is not tasked with providing guidance to supplement (a variety of differing national) laws or regulations at an international level. Besides making the Code questionable in terms of its likely effectiveness as guidance to supplement specific national laws, certain aspects of the proposals remain potentially detrimental to the profession and to audit quality, and as such are not in the public interest.*

   *The Code needs to be very clear on this point, so as to preclude misunderstanding in this highly sensitive aspect. Whilst the last sentence of paragraph 225.29 the Code does state "Disclosure would be precluded if it would be contrary to law or regulation", this information may be easily overlooked when other paragraphs are read in isolation. Paragraphs 225.10, 225.19 and 225.33 serve to draw PAs' attention to any existing obligations under national laws and regulations that require NOCLAR be reported to an external authority. As a minimum, it would be equally appropriate to add a further subsection (c) to paragraph 225.19 to draw attention to the fact that national laws may contain client confidentiality provisions that expressly prohibit further disclosure, including disclosure under the revised IESBA Code and to acknowledge such possible preclusions in paragraph 225.24.*

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?

   *As explained above, we believe that IESBA is not the appropriate party to either require or "allow" a breach of client confidentiality beyond existing provisions within national laws and regulations.*

   *The IESBA proposals in regard to a) the matters an auditor would (under the Code) potentially disclose to an external authority and b) the circumstances surrounding a determination to do so are (necessarily – given the nature of an international Code) overly vague. In our view, this lack of precision creates considerable uncertainty. Should IESBA, however, retain this aspect of its proposals, we believe that when there is no legal or regulatory requirement to report identified or suspected NOCLAR to an appropriate authority the Code needs to allow the auditor to weigh up the public*

*interest implications of disclosure on the one hand against a breach in client confidentiality on the other in determining which should prevail in the individual audit engagement circumstances. This should involve consideration of aspects such as legal risks associated with the auditor potentially making a false accusation, and breaking client confidentiality without the client's knowledge or in the absence of the client's explicit permission.*

*In paragraph 225.14 IESBA rightly recognizes that "Whether an act constitute actual non-compliance is ultimately a matter for determination by an appropriate legal or adjudicative body." On this basis it would be appropriate for the determination required of the auditor to include a consideration of the likelihood of prosecution as a factor in determination of further action.*

*In addition, we note that the proposals do not give due regard to factors such as the contractual obligations to uphold client confidentiality. These ought to be addressed, as without this a PA complying with this aspect of the Code might be in breach of contract.*

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;

    *We believe that the potential unintended consequences described in para. 60 (i.e., detrimental impact on free flow of information between clients and PAs damaging audit quality in particular and discouraging senior PAs from remaining in the profession), and possible other consequences, are also relevant in respect of the ED. The proposals potentially create a de facto requirement for auditors to breach client confidentiality in some circumstances and that this, together with the lack of clarity as to what and when auditors would report externally, would create considerable uncertainty. It is this uncertainty that we believe will trigger unintended consequences which could ultimately be detrimental to audit quality.*

    *Proposed Extension of Audit Procedures beyond the relevant requirements of ISA 250 - When the auditor becomes aware of information concerning an instance of noncompliance, ISA 250.18 requires the auditor to obtain an understanding of the nature of the act and the circumstances in which it has occurred. Related application guidance in ISA 250.A13 provides examples of the types of information that may be relevant in this context, indicating that the auditor's understanding would be expected to be of a relatively general nature at this initial stage. Following on from this, ISA 250.19 puts the onus firmly on the entity's management and where appropriate those charged with governance to investigate suspected instances of non-compliance and provide to the auditor sufficient information to dispel such suspicion.*

*In contrast, paragraph 225.11 of the Code proposes the auditor be required to obtain a more comprehensive understanding of the matter – extending the term "matter" to include both acts that have occurred as well as those that may yet occur, and extending the understanding to specifically include the application of the relevant laws and regulations to the circumstances. Thus, before any discussion with the entity's officers the proposed changes to the Code exceed extant ISA 250 and would specifically require the auditor "probe into" the matter more thoroughly than is required under ISAs.*

*We believe this proposed "difference" between ISA 250 and the Code is inappropriate on two counts. Firstly, in practice the auditor's required "understanding" under the Code would lead auditors to "firm up on" facts as a prerequisite to obtaining an understanding of the legal position, as – in contrast to ISA 250 – it appears that the Code is dealing with relatively well founded suspicions at this stage. Indeed, obtaining an understanding of the legal position pertaining to the individual matter (which is not required under ISA 250 at this stage) will often involve recourse to legal advice (also regulators would expect diligent documentation), which would certainly add costs to audits. Secondly, in placing the duty on the auditor at this initial stage instead of on management potentially may also lay the auditor open to claims, should the auditors "probing" be perceived as a false accusation, deformation of character or similar or in the worst case, lead to e.g., a formal investigation that may subsequently dispel the original suspicion. In addition, a perception of excessive probing by the auditor prior to a discussion of the matter with the entity's officers beyond "normal" audit procedures could be detrimental to the auditor's relationship with the client.*

*We do not believe there is justification for a different approach in any of these areas, and suggest the IESBA align the required work effort more closely to ISA 250.*

b. Other PAs in public practice and their clients; and

*We believe that the proposals that would allow other PAs to breach client confidentiality in some circumstances, together with the lack of clarity as to what and when PAs might report externally, creates considerable uncertainty. It is this uncertainty that we believe will trigger the unintended consequences, including potential move from professional accountants subject to the Code to others (in some cases perhaps less qualified) who are not.*

c. PAIBs and their employing organizations.

*We support the board's proposals in relation to PAIB since they are engaged more actively in the activities of the organisation thus more likely to know or are involved in acts of NOCLAR. Ins such instances, it's important to obligate them to*

*report to relevant persons, appropriate authority (paragraphs 360.26-28), and/or the independent auditor (paragraphs 360.17-18.)*

*Specific Matters*

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

   *We agree with the proposed objectives (a) and (b) of paragraph 225.3. Whilst we agree in principle with the intention of (c), we are concerned that the term "public interest" may make it open to overly wide and divergent interpretation, as there is no definitive understanding of what "public interest" entails. Even when laws are in place the interpretation of the term "public interest" is not necessarily clear.*

   *Perceptions as to what "action needed in the public interest" actually constitutes in any given situation will depend on the specific situation and is also highly subjective. Thus, although various aspects of this particular proposal may be in the public interest, other aspects may be detrimental to the public interest. It may be more appropriate to word this part of the objective as being generally in the public interest or overall in the public interest, and to point out that what is or is not in the public interest will depend on a number of factors as well as being highly subjective*

   *We do, however, fail to see how excluding PAs undertaking work for which they have no direct engagement fits in with the Board's stated objectives, since the proposed scope out will ensure that these PAs do indeed turn a blind eye to identified or suspected NOCLAR (see paragraphs.13 and 15 of the Explanatory Memorandum). Requiring that PAs do not turn a blind eye on all but those situations where they have an indirect engagement is likely to lead to public misunderstanding as to the "integrity" of the profession when viewed as a whole.*

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

   *We agree that it is appropriate for auditors to be governed by ISA 250 as to the description of laws and regulations applicable for the purposes of the Code (paragraph 22 of the Explanatory Memorandum).*

   *However, we continue to take issue with the explanation in paragraph 29 of the Explanatory Memorandum and proposed paragraph 225.7 of the Code which seek to extend instances of NOCLAR under the Code beyond the auditor's mandate under ISA 250 (i.e., moving beyond the impact on the financial statements to include substantial harm to the wider public). Whilst we appreciate that the IESBA is now proposing to limit the scope of matters that would be reported externally to serious instances of NOCLAR with a public interest connotation, we continue to believe that this aspect of the proposals introduces a lot of uncertainty as to the scope of NOCLAR as well as detectability by the auditor, which, at best, will lead to an expectations'*

*gap and at worst could have serious implications for the accountancy profession as already discussed.*

*Indeed, we were interested to note an example of such an expectation that has already come to the Board's attention. Paragraph 28 of the Explanatory Memorandum explains that the Board was made aware of expectations as to insider trading, and has stated that insider trading is generally extremely difficult to prove in practice. Nevertheless, the Board is now proposing to add laws and regulations that deal with securities markets and trading to the list of examples in paragraph 225.5 to address the comment received, without mention of these associated difficulties at all. Indeed, following the argument the Board has put forward in paragraph 34 of the Explanatory Memorandum as to thresholds, we are not convinced that laws and regulations that deal with securities markets and trading will generally fall into either category defined in paragraph 225.7, other than perhaps in relation to entities in the investment industry, and do not agree that this can be regarded as a general example in this context.*

*If the Board decides to retain its proposed stance in this area, there needs – in line with ISA 250.07 – to be a clear distinction between those matters an auditor could generally be expected to identify (i.e., as described in ISA 250.06(a)), those matters an auditor may generally be expected to identify (i.e., as described in ISA 250.06(b)), and those that may be far less likely to be identified during the course of an audit (i.e., as mentioned in ISA 250.08 and .15).*

*ISA 250.05 explains the possible impact of inherent limitations of the audit on the auditor's ability to detect non-compliance in the performance of the audit.*

*We note that the IESBA is not proposing to acknowledge these in the Code, but believe that a better understanding of such limitations is needed to reduce unrealistic expectations in this area.*

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

*We accept that a differential approach is needed. However we do not fully agree with the proposals as to how this would be achieved.*

*We agree that the scope of NOCLAR for PAs other than auditors should not go beyond the "ISA 250 scope". However, we believe that proposing to use this for all PAs, regardless of their roles and levels of seniority (paragraph 22) may be problematical in terms of public expectations as to the capability of the accounting profession as a whole. It is essential that the public understand that whilst statutory auditors have an audit mandate that means it is reasonable to anticipate that they may be in a position to identify NOCLAR in such areas, for other PAs any ability to*

*identify NOCLAR is intrinsically less since it is directly linked to the nature and scope of their individual roles.*

*We note that the proposed requirement in paragraph 225.34 contains the following limitation: "if, in the course of providing a professional service to a client, the PA becomes aware of information concerning an instance of NOCLAR or suspected NOCLAR…" and believe that this limitation will need to be clearer in the subsection entitled "scope" (paragraphs 225.5-.8).*

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?

    *The factors are – necessarily in an international Code such as the IESBA Code – too vague and subjective in nature, and the interaction between the factors makes the required determination highly complex for auditors, their legal advisors, regulators or relevant professional bodies whom the auditor consults on a confidential basis and all other interested parties. For example, "urgency of the matter" is not always clearly evident. What degree of urgency would "cross the threshold"? Under the Code there is no mechanism parallel to case law to clarify such issues. In some countries this may be less problematical, as it may even be appropriate to draw on similar case law, but in many countries this type of issue will be highly problematical and will likely mean that this aspect of the Code proves unworkable.*

    *The entire responsibility for reaching a "correct" determination is forced on the professional judgement of the auditor (possibly after consultation), who, as explained in our accompanying letter, is then wide open to claims from whichever party believes it has suffered as a result of a possible wrong determination on the part of the auditor.*

    *As we have already stated, in our view, such sensitive issues demand legal certainty and should be dealt with by legislation, and not by the IESBA Code.*

    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 third party test is highly subjective, and the interpretation is likely to be impacted by cultural influences, which will lead to inconsistent application of the Code by professional accountants, audit regulators and courts of law.*

    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?

*In our view, providing disclosure as the only mutually exclusive course of action essentially "forces" a de facto requirement in certain circumstances for a PA to disclose to an authority notwithstanding that there is no legal or regulatory requirement to do so. If this were a straightforward issue, the IESBA would have proposed a variety of possible courses of action – and acknowledged that taking no action may be appropriate even if the "forced determination" indicated otherwise. Subject to our reservations as to the determination itself, resigning from the engagement/relationship would appear to be an essential course of action, but may be precluded in some jurisdictions.*

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

*The factors are – necessarily in an international Code such as the IESBA Code – too vague and subjective in nature and the interaction between the factors makes the required determination highly complex for auditors, their legal advisors, regulators or relevant professional bodies whom the auditor consults on a confidential basis and all other interested parties. For example, what are the thresholds for judging when the actual or potential "harm to the interests of the client, investors, creditors, employees or the wider public" crosses the line in terms of its nature or of its extent or both? What is "an appropriate authority" in this context – does their track-record for taking action count or not in this determination or is it merely their existence? Given the sensitivity surrounding whistle-blowing, does the existence of whistle-blowing legislation alone count or should the auditor only disclose if satisfied as to its effectiveness? Under the Code there is no mechanism parallel to case law to clarify such issues.*

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?

*In our view, as a matter of principle provisions requiring a PA to "consider" a matter are insufficiently clear. This term is notoriously difficult to translate, as it can have various different meanings in English ranging from the notion that a matter shall not be discounted to a deeper weighing up of multiple aspects of a matter. We note, for example, that the IAASB made a conscious decision to be more precise and avoid as far a possible requirements for auditors to consider matters.*

*We do not understand what justification the IESBA has in paragraph 225.40 in proposing that the existence of a network should trigger a consideration for the PA to inform the auditor of matters below the "further action required threshold", whereas when no network relationship exists the auditor would not be so informed. The nature and seriousness of the matter ought to be factors in such a consideration, not the nature of PAs relationships. Furthermore, the IESBA needs to be aware that client*

*confidentiality provisions in law may also preclude compliance with paragraph 225.40.*

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

   *Paragraph 225.32 extends the documentation requirements of ISA 250 when the auditor encounters an incidence of NOCLAR. It would be more appropriate to have this reflected within ISA 250 rather than auditors having to refer to two different sources for audit documentation.*

   *We note that although paragraph 225.7 expands what the auditor shall regard as NOCLAR beyond ISA 250, the documentation requirements do not reflect a need to explain this. We suggest that in the event of a NOCLAR that is beyond the scope of ISA 250, it would likely be appropriate to document the facts and reason for inclusion.*

   *In relation to PAs providing services other than audit, paragraph 225.48 does not require but instead "encourages" documentation, and then only when the NOCLAR "is a significant matter". Firstly, encouragement seems somewhat contrary to the Board's objectives with this project. Secondly, there needs to be some definition of the term "is a significant matter" in this context.*

**Request for General Comments**

In addition to the request for specific comments above, the Board is also seeking comments on the matters set out below:

a) PAIBs working in the public sector— Recognizing that many PAIBs work in the public sector, the Board invites respondents from this constituency to comment on the revised proposals and, in particular, on their applicability in a public sector environment.

   *In our opinion the concerns and considerations outlined above apply equally to PAIB's when they provide services in the public sector.*

   *ICPAK members may be engaged to perform audits or other professional work in the public sector. An auditor in the public sector is required to report incidences of NOCLAR to the supreme audit institution which has a statutory responsibility for following up on such matters.*

b) Developing Nations—Recognizing that many developing nations have adopted or are in the process of adopting the Code, the Board invites respondents from these nations to comment on the proposals, and in particular, on any foreseeable difficulties in applying them in their environment.

   *Our legal framework is well developed to support the accountancy profession. The legal framework provides stringent requirements to address issues of non-compliance with laws and regulations.*

c) Translations—Recognizing that many respondents may intend to translate the final pronouncement for adoption in their environments, the Board welcomes comment on potential translation issues respondents may note in reviewing the revised proposals.

*N/A*