

RESPONDING TO FRAUD AND ILLEGAL ACTS – IESBA PROJECT PROPOSAL

I. Subject

1. This project will include:

- (a) Revisions to Section 140 *Confidentiality* to provide additional guidance to professional accountants on how to respond when encountering a suspected fraud or illegal act;
- (b) A new section in Part B to provide guidance for professional accountants in public practice how to respond when encountering a suspected fraud or illegal act; and
- (c) A new section in Part C to provide guidance for professional accountants in business how to respond when encountering a suspected fraud or illegal act.

The project will not address a professional accountant's responsibility for detecting such acts or provide guidance on how to detect such acts.

II. Background

2. A professional accountant in public practice or business may encounter situations including:
 - The professional accountant discovers a suspected fraudulent or illegal act;
 - The professional accountant has reported an alleged fraudulent or illegal act but no action has been taken, or the action is inadequate; and
 - Another individual within the organization has informed the professional accountant about the existence of a suspected fraudulent or illegal act.
3. Section 140 contains general guidance for all professional accountants regarding disclosure of confidential information. It identifies three circumstances where professional accountants are required, or may be required, to disclose confidential information:
 - Disclosure is permitted by law and is authorized by the client or the employer;
 - Disclosure is required by law; and
 - There is a professional duty or right to disclosure when not prohibited by law.
4. The Code does not contain any guidance on when there is a profession duty or right to disclose confidential information when not prohibited by law. The goal of the project is to provide guidance for professional accountants on how to respond in situations where they encounter a suspected fraud or illegal act.

III. Project Objective and How It Serves the Public Interest

A. Project Objective

5. The objective of the project is to revise Section 140 and develop two new sections in Parts B and C to provide additional guidance for professional accountants in public practice and in business on how to respond in situations where they encounter a suspected fraud or illegal act.

B. How the Project Objectives Serve the Public Interest

6. Providing additional guidance for professional accountants on how to respond in situations

where they encounter a suspected fraud or illegal act serves the public interest because it can provide the public with increased comfort that the professional accountant has a clear framework with which to address such matters, which can promote more consistent behavior that is appropriate and expected under the Code.

IV. Outline of the Project

A. Project Scope

7. The scope of this project is to revise Section 140 and develop two new sections in Parts B and C to provide additional guidance for professional accountants in public practice and in business on how to respond in situations where they encounter a suspected fraud or illegal act. The project will focus on the actions that the professional accountant takes when encountering such a situation. It will not address actions that professional accountants should take to identify such matters.

B. Revision of Section 140 and Development of Additional Sections in Parts B and C – Major Problems and Key Issues that Will Be Addressed

B.1 AREAS FOR ADDITIONAL GUIDANCE

8. The task force will address the extent to which additional guidance is needed on the following:
 - *Legislative environment* – Many jurisdictions have “whistle blowing” legislation, some of which is quite extensive. The project will recognize the existence of such legislation and note that, depending on the jurisdiction, the professional accountant may have a legal obligation to report under such legislation. The project will not cross-reference to any particular piece of legislation nor attempt to categorize all types of existing legislation. There may be instances where the professional accountant cannot lawfully overcome confidentiality restrictions. The project will recognize this matter.
 - *Nature of Items to be Addressed* – A description of the types of matters that will be addressed is critical to solidifying the scope of the project. The task force will, therefore, at an early stage in the project define the types of confidential matters that the professional accountant may need to disclose as a result of a suspected fraud or illegal act. Subject to the recommendation in the last paragraph of this bullet point, the task force should restrict this to suspected fraud or illegal acts.

With respect to fraud, the task force should be mindful of *ISA 240, The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements*, which defines a fraud as “an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.” With respect to illegal acts, the task force should be mindful of *ISA 250, Consideration of Laws and Regulations in an Audit of Financial Statements*, which deals with the auditor’s responsibility to consider laws and regulations when performing a financial statement audit. In this regard, the ISA refers to non-compliance with laws and regulations. The ISA defines non-compliance as “Acts of omission or commission by the entity, either intentional or unintentional, which are contrary to the prevailing laws or regulations. Such acts include transactions entered into by, or in the

name of, the entity, or on its behalf, by those charged with governance, management or employees. Non-compliance does not include personal misconduct (unrelated to the business activities of the entity) by those charged with governance, management or employees of the entity.”

In addition to describing the types of matters that will be addressed, the task force will consider developing specific examples of these matters.

While the initial presumption of the task force should be to restrict the matters to be addressed to suspected fraud or illegal acts, the task force should consider whether the scope of the project should be wider and address, for example, matters that are “unethical” or “improper.” The task force should present its views on this matter at an early stage in the project. If the task force believes the project should have a wider scope, it should present its reasons to the IESBA, together with examples of the types of matters that would fall into this broader category, and thus would be appropriate for a professional accountant to disclose. It also should discuss the extent to which a broader project would intersect with the guidance in Section 100 on ethical conflict resolution.

- *Threshold for Taking Action* – The task force will consider what guidance can be provided to a professional accountant regarding the threshold for taking action. In this regard the task force should consider the “probability” that a fraud or illegal act has occurred and the “effect” of such an act. Whether an act constitutes a fraud or illegal act is ultimately a matter for legal determination in a court of law. The professional accountant will, therefore, likely identify a “suspected” fraud or illegal act. The task force will consider what guidance can be given to the professional accountant regarding the level of suspicion that should be brought to bear in making that identification. The task force will also consider the effect or magnitude of the suspected fraud or illegal act. For example, a minor breach of a regulation would be unlikely to be of such a magnitude that the accountant would need to consider disclosure. In this regard, the task force will consider whether useful guidance can be given on how the professional accountant would consider the level of public interest associated with the matter and what steps the accountant would take to ensure an understanding, to the extent possible, of the complete picture and so that the accountant is not acting on unsubstantiated information.
- *Process for Responding* – The task force will develop guidance on the thought process the professional accountant would use in determining how to respond to a suspected fraud or illegal act. The task force should consider a sequential approach in which the professional accountant first discusses the matter with a superior and, if appropriate action is not taken, elevates the matter within the employing organization or client, as the case may be. If the matter is still not resolved, the professional accountant would then consider the need to report outside of the employing organization or client. The task force will consider what guidance can be given to ensure that the accountant responds in a measured manner. The task force should consider the extent to which the guidance in Section 100 on ethical conflict resolution interacts with its recommend guidance on fraud and illegal acts.
- *Timing of Disclosure* – The task force will consider what guidance is necessary regarding the timing of disclosure in situations when the matter cannot be resolved and the professional accountant determines that disclosure is necessary, taking into consideration

the Section 100 guidance on ethical conflict resolution.

- *Documentation* – The task force will consider what guidance should be given regarding the matters that should be documented by the professional accountant.

B.2 STRUCTURE OF THE GUIDANCE

9. Section 140 provides guidance for all professional accountants. The task force will consider whether guidance that is common to all accountants should be included in Section 140 or whether it should be repeated in the two new sections in Parts B and C.

V. Implications for Any Specific Persons or Groups

10. The project has particular implications for the following:
 - (a) Professional accountants in public practice;
 - (b) Professional accountants in business; and
 - (c) Regulatory bodies.

VI. Development Process, Public Consultation, Project Timetable and Project Output

11. The revision of Section 140 and development of new sections will follow due process for the development of a pronouncement. The project will include development of a consultation paper that will be exposed for public comment to solicit views on the scope of the project, including the matters that will be addressed.
12. Specific consideration will be given to the need to hold focus groups or roundtables to ensure relevant feedback is obtained from those with direct interest in how a professional accountant responds when encountering a suspected fraud or illegal act.

A. Project Timetable

Project Stage	Timing
Approval of project proposal by IESBA	Q4 2009
Consultation Paper first read	Q2 2010
Consultation Paper approval	Q4 2010
Review comments on consultation	Q2 2011
Exposure Draft first read	Q4 2011
Exposure Draft approval	Q1 2012
Full review of exposure draft comments and first read post-exposure	Q4 2012
Final standard approval	Q2 2013

B. Project Outputs

13. Revisions to Section 140 and two new sections in Parts B and C of the Code.

VII. Impact Assessment Considerations

14. The primary benefit in identifying and developing additional guidance for professional accountants when encountering suspected fraud and illegal acts will be to improve accountants' ability to respond to such matters in a more consistent manner and provide the public with greater comfort that the professional accountant has a clear framework with which to address such matters.

VIII. Resources Required

15. A project task force consisting of up to 6 individuals, including a member of the IESBA as chair.
16. IESBA technical staff will provide staff support to the task force.

IX. Relevant Sources of Information that Address the Matter Being Proposed

17. Relevant sources of information include the following:
 - Practice Note 19 – The Audit of Banks and Building Societies in the United Kingdom Revised APB <http://www.frc.org.uk/apb/publications/pub1254.html>
 - OECD Anti-bribery Convention http://www.oecd.org/departement/0,3355,en_2649_34859_1_1_1_1_1,00.html
 - Tech 17/99 Public Interest Disclosure Act 1988 Guidance ICAEW http://www.icaew.com/index.cfm/route/121330/icaew_ga/pdf
 - Defining and Developing an Effective Code of Conduct for Organizations IFAC Public Accountants in Business Committee <http://www.ifac.org/Members/DownLoads/DefiningandDevelopinganEffectiveCodeofConductforOrgs.pdf>

Appendix 1

COMMENTS BY TECHNICAL MANAGERS

[The project proposal has been circulated to Technical Managers for comment. Comments received will be tabled at the Tokyo meeting.] The comments of Technical Manager from each technical area are required before this Project Proposal is considered by the board or committee proposing to undertake the project.

Technical Manager to the Compliance Advisory Panel

Signed: _____

Date: _____

Technical Manager to the Developing Nations Committee

Signed: _____

Date: _____

Technical Manager to the IAESB

Signed: _____

Date: _____

Technical Manager to IAASB

Signed: _____

Date: _____

Technical Manager to the PAIB Committee

Signed: _____

Date: _____

Technical Manager to the IPSASB

Signed: _____

Date: _____

Technical Manager to the SMP Committee

Signed: _____ Date: _____

Technical Manager to the Transnational Auditors Committee

Signed: _____

Date: _____