

DRAFT WORDING

Responding to Suspected Fraud or Illegal Acts

- 225.1 This section provides guidance to a professional accountant in public practice on how to respond when the accountant encounters a suspected fraud or illegal act in the course of performing a professional service. Some frauds and illegal acts are required under law or regulation to be disclosed to an appropriate authority. If such disclosure is required, a professional accountant shall comply with the disclosure requirements. Where disclosure is not required under law or regulation, a professional accountant in public practice may nevertheless be required by this section to disclose the matter outside of the organization to an appropriate authority, if such disclosure would be in the public interest.
- 225.2 Fraud is 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. Illegal acts comprise acts of omission or commission, intentional or unintentional, which are contrary to the prevailing laws or regulations. This section addresses an accountant's responsibility when encountering a fraud or an illegal act which could have a direct or indirect effect on the financial reporting of the client. Examples of such frauds or illegal acts include:
- Fraudulent financial reporting involving intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statement users;
 - Misappropriation of assets;
 - Money laundering offences;
 - Tax evasion;
 - Insider trading and bribery;
 - Environmental offences; and
 - Breaches of employment legislation.
- 225.3 Whether a matter constitutes a fraud or an illegal act is ultimately a matter for legal determination by a court of law, this section, therefore addresses suspected fraud or illegal acts. If, during the course of performing a professional service, a professional accountant in public practice encounters a suspected fraud or illegal act, or a member of the client's staff discloses such a matter to the accountant, the accountant shall determine the appropriate course of action to take.
- 225.4 If a professional accountant in public practice in the course of performing a professional service acquires information which leads the accountant to suspect that a fraud or illegal act may have been committed, the

accountant shall take reasonable steps to confirm or dispel that suspicion. In doing so, the professional accountant is expected to apply appropriate levels of knowledge, judgment and expertise when considering the matter, but is not expected to have detailed knowledge of laws and regulations beyond that which is required for the professional services for which the accountant was engaged.

- 225.5 If the professional accountant is unable to dispel the suspicion, and, therefore, in the accountant's professional judgment a suspected fraud or illegal act exists, the accountant shall discuss the matter with the appropriate level of management. The determination of which level of management is the appropriate one is a matter of professional judgment and is affected by factors such as the likelihood of collusion and the magnitude of the matter. The appropriate level of management is generally at least one level above the persons who appear to be involved in the matter. If the response to the matter is not appropriate, the professional accountant shall discuss the matter with a higher level of management or those charged with governance as appropriate. If the professional accountant suspects that senior management is implicated in the matter, the accountant shall discuss the matter directly with those charged with governance.
- 225.6 The professional accountant shall determine whether, after communicating the matter to either management or those charged with governance, the matter has been satisfactorily addressed. This will depend upon factors such as:
- Whether the matter was appropriately investigated;
 - Whether appropriate available remedial action has been taken to address the matter;
 - Whether steps have been taken to reduce the risk of re-occurrence, such as for example, additional controls or training; and
 - Whether the entity has disclosed the matter to an appropriate authority, or intends to do so within a reasonable period of time.
- 225.7 If, in the professional accountant's judgment, the matter has not been satisfactorily addressed the accountant shall determine the appropriate course of action, including whether to resign from the client.
- 225.8 If the client has not disclosed the matter to an appropriate authority within a reasonable period of time and the accountant determines that disclosure would be in the public interest, the professional accountant shall disclose the matter in a timely manner to an appropriate authority. The determination of whether disclosure would be in the public interest will require professional judgment and the professional accountant may

wish to consult with their member body or seek legal advice. Whether the public interest is served by disclosure will depend upon factors such as:

- The significance to the client's financial reporting;
- The extent to which external parties are likely to be affected; and
- The likelihood of recurrence.

225.9 The appropriate authority will depend on the nature of the suspected fraud or illegal act; for example a tax authority in the case of tax evasion, and a securities regulator in the case of fraudulent financial reporting in a listed entity. In determining which party is the appropriate authority, the professional accountant may wish to consult with a member body or seek legal advice.

225.10 The professional accountant may wish to seek legal advice to obtain an understanding of any protection afforded by legislation if the accountant discloses the matter to a party outside of the client, such as is afforded in some jurisdictions under whistleblowing legislation.

225.11 When required by law to disclose the matter, for example as a result of anti-money laundering legislation, a professional accountant in public practice shall disclose that information in compliance with the relevant legal requirements.

225.12 The professional accountant shall document the steps the accountant took to respond to the suspected fraud or illegal act, including the persons consulted, responses received and the disclosure, if any, made to an appropriate authority.

300.5 A professional accountant in business may hold a senior position within an organization. The more senior the position, the greater will be the ability and opportunity to influence events, practices and attitudes. A professional accountant in business is expected, therefore, to encourage an ethics-based culture in an employing organization that emphasizes the importance that senior management places on ethical behavior. Established whistle-blowing procedures that are in place and understood by all employees may be useful to achieve the objective of establishing and maintaining an ethics-based culture. Such procedures help to deter malpractice and increase the likelihood of senior management being alerted to a problem in time to prevent serious damage.

Responding to Suspected Fraud or Illegal Acts

360.1 This section provides guidance to a professional accountant in business on how to respond when the accountant encounters a suspected fraud or illegal act in the course of undertaking a professional activity¹. Some frauds and illegal acts are required under law or regulation to be disclosed to an appropriate authority. If such disclosure is required, a professional accountant shall comply with the disclosure requirements. Where disclosure is not required under law or regulation, a professional accountant may nevertheless be required by this section to disclose the matter outside of the organization to an appropriate authority, if such disclosure would be in the public interest.

360.2 Fraud is 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. Illegal acts comprise acts of omission or commission, intentional or unintentional, which are contrary to the prevailing laws or regulations. The section addresses an accountant's responsibility when encountering a fraud or an illegal act which could have a direct or indirect effect on the financial reporting of the employing entity. Examples of such frauds or illegal acts include:

- Fraudulent financial reporting involving intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statement users;
- Misappropriation of assets;
- Money laundering offences;
- Tax evasion;

¹ A professional activity is defined as "Activities requiring accountancy or related skills undertaken by a professional accountant including accounting, auditing, taxation, management consulting and financial management."

- Insider trading and bribery;
 - Health and safety offences;
 - Environmental offences; and
 - Breaches of employment legislation.
- 360.3 Whether a matter constitutes a fraud or an illegal act is ultimately a matter for legal determination by a court of law, this section, therefore addresses suspected fraud or illegal acts. If, during the course of undertaking a professional activity, a professional accountant in business encounters a suspected fraud or illegal act, the accountant shall determine the appropriate course of action to take.
- 360.4 If a professional accountant in business in the course of performing a professional activity encounters circumstances which lead the accountant to suspect that a fraud or illegal act may have been committed, the accountant shall take reasonable steps to confirm or dispel that suspicion. In doing so, the professional accountant is expected to apply appropriate levels of knowledge, judgment and expertise, but is not expected to have detailed knowledge of laws and regulations beyond that which is required for the professional activities the accountant is undertaking. In attempting to gather additional information, the professional accountant shall exercise professional judgment in deciding who to discuss the matter with since this will depend upon the nature of the suspected act, the circumstances giving rise to the act and the individuals involved.
- 360.5 If the professional accountant is unable to dispel the suspicion and, therefore, in the accountant's professional judgment a suspected fraud or illegal act exists, the accountant shall determine the appropriate course of action, taking into account whether the organization has an established mechanism, such as an ethics policy, for addressing such matters, whether the matter is required to be reported under law or regulation and the existence of any whistleblowing provisions.
- 360.6 The professional accountant shall generally first disclose a suspected fraud or illegal act within the reporting lines of the employing organization by reporting the matter to a superior. If the matter is not, in the accountant's professional judgment, satisfactorily addressed the accountant shall discuss the matter with a higher level of authority within the organization such as those charged with governance or shall disclose the matter to the entity's external auditor.
- 360.7 If the professional accountant in business suspects that the accountant's superior or management is involved in the suspected fraud or illegal act, the accountant shall report the matter to a higher level of authority within the organization such as those charged with governance or shall report the matter to the entity's external auditor.

360.8` The professional accountant shall determine whether, after communicating the matter either to management, those charged with governance of the entity's external auditor, the matter has been satisfactorily addressed. This will depend upon factors such as:

- Whether the matter was appropriately investigated;
- Whether appropriate available remedial action has been taken to address matter;
- Whether steps have been taken to reduce the risk of re-occurrence, such as for example, additional controls or training; and
- Whether the matter has been disclosed to an appropriate authority, or disclosure will take place within a reasonable period of time.

360.9 If, in the professional accountant's judgment, the matter has not been satisfactorily addressed the accountant shall determine the appropriate course of action, including whether to resign from the employing organization.

360.10 If the matter has not been disclosed to an appropriate authority within a reasonable period of time and the accountant determines that disclosure would be in the public interest, the accountant shall disclose the matter in a timely manner to an appropriate authority. The determination of whether reporting would be in the public interest will require professional judgment and the professional accountant may wish to consult with their member body or seek legal advice. Whether the public interest is served by disclosure will depend upon factors such as:

- The significance to the entity's financial reporting;
- The extent to which external parties are likely to be affected; and
- The likelihood of recurrence.

360.11 The appropriate authority will depend upon the nature of the suspected fraud or illegal act; for example a tax authority in the case of tax evasion and a securities regulator in the case of fraudulent financial reporting in a listed entity. In determining which party is the appropriate authority, the professional accountant may wish to consult with a member body or seek legal advice.

360.12 The professional accountant may also wish to obtain legal advice to obtain an understanding of any protection afforded by legislation, such as whistleblowing legislation, if the accountant discloses the matter to a party outside of the employing organization.

360.13 When required by law or legislation to disclose the matter, for example as a result of anti-money laundering legislation, a professional accountant shall disclose that information in compliance with the relevant legal requirements.

360.14 The professional accountant shall document the steps the accountant took to respond to the suspected fraud or illegal act, including the persons consulted, responses received and the disclosure, if any, made to an appropriate authority.