

Responding to a Suspected Fraud or Illegal Act

Bob Franchini

New Delhi, India

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Responding to Suspected Fraud or Illegal Act

- Background
- Nature of items to be addressed
- Process for responding
- Actions to be taken after disclosing within an organization

Background

- The Code states that distinguishing mark of the accounting profession (100.1) is:
 - Acceptance of responsibility to act in the public interest
 - Responsibility not exclusively to satisfy the needs of an individual client or employer
- Confidentiality is one of five fundamental principles with which the professional accountant must comply (100.5)

Confidentiality – Fundamental Principle

“to respect the confidentiality of information acquired as a result of professional and business relationships and, therefore, not disclose any such information to third parties without proper and specific authority, *unless there is a legal or professional right or duty to disclose*, nor use the information for the personal advantage of the professional accountant or third parties” (100.5)

Circumstances for Disclosure

- Disclosure permitted by law and is authorized by client or employer
- Disclosure required by law
- *Professional duty or right to disclose when not prohibited by law*

Project scope

- Revisions to Section 140 *Confidentiality*
- New section in Part B providing practical guidance on how to respond when encountering suspected fraud or illegal acts
- New section in Part C providing practical guidance on how to respond when encountering suspected fraud or illegal acts

Nature of items to be addressed

- ISA definitions
 - Fraud - “intentional acts ... involving the use of deception to obtain an unjust or illegal advantage”
 - Illegal acts – “acts of commission or commission by the entity which are contrary to prevailing laws and regulations”
- Fraud or illegal acts that have a direct or indirect effect on the financial reporting of the client or employing organization

Nature of items to be addressed

- Other matters?
 - Unethical
 - Improper
- Too subjective
- Some guidance already contained in paragraphs 210.1-210.5 (Client Acceptance) and paragraph 300.15

Unethical and improper behavior

- Paragraphs 210.1-210.5
 - Before accepting a new client relationship...determine whether acceptance would create any threats to compliance with the fundamental principles. Potential threats to integrity or professional behavior may be created from, for example, questionable issues associated with the client (its owners, management or activities)
 - Client issues that, if known, could threaten compliance with the fundamental principles include, for example, client involvement in illegal activities (such as money laundering), dishonesty or questionable financial reporting practices.

Unethical and improper behavior

- Paragraph 300.15
 - In circumstances where a professional accountant in business believes that unethical behavior or actions by others will continue within the employing organization, the accountant may consider obtaining legal advice. In those extreme situations where all available safeguards have been exhausted and it is not possible to reduce the threat to an acceptable level, an accountant may conclude that it is appropriate to resign from the employing organization

Process for Responding

- Sequential approach
- Disclose within the client or employing organization
 - To management at an appropriate level
 - If management response not appropriate to a higher level of authority
 - For a professional accountant in business could disclose to the entity's external auditor

Satisfactorily addressed

- Matters appropriately investigated
- Appropriate remedial action taken
- Steps taken to reduce risk of re-occurrence
- Disclosure made to an appropriate authority, or disclosure will be made within a reasonable period of time

Action to be taken after internal disclosure

- Matter not satisfactorily addressed
 - Calls into question integrity of client or employer
 - Existing guidance in Code in paragraphs 210.1-210.5 and paragraph 300.15 would point to resignation
 - New paragraphs 225.7 and 360.9
 - “If the matter... has not been satisfactorily resolved, the accountant shall determine the appropriate course of action including whether to resign from the client (or employing organization)”
 - If not disclosed to an appropriate authority by the entity the professional accountant should determine whether such a disclosure would be in the public interest



Action to be taken after internal disclosure

- Whether it is in the public interest will depend upon
 - Significance to the entity's financial reporting
 - Extent to which external parties are likely to be affected
 - Likelihood of recurrence

Action to be taken after internal disclosure

- Alternatives for external disclosure considered by Task Force
 - Accountant shall determine whether to disclose
 - Accountant is encouraged or expected to disclose
 - Requirement to disclose if disclosure is in the public interest, unless outcome would be disproportionate
 - Requirement to disclose if disclosure is in public interest

Action to be taken after internal disclosure

- Alternatives for external disclosure considered by Task Force
 - Accountant shall determine whether to disclose
 - Consequence – accountant to demonstrate he/she made a determination
 - Accountant is encouraged or expected to disclose
 - Consequence – accountant to demonstrate why encouragement or expectation not appropriate in the circumstances
 - Requirement to disclose if disclosure is in the public interest, unless outcome would be disproportionate
 - Consequence - accountant to demonstrate why outcome would be disproportionate
 - Requirement to disclose if disclosure is in public interest
 - Consequence – accountant to demonstrate why disclosure not in public interest

Factors considered by Task Force

- A distinguishing mark of the accountancy profession is its acceptance to act in the public interest (first sentence of Code)
- Balancing of principle of confidentiality and public interest

Factors considered by Task Force

- Determination of whether there is a need to report and encouragement/expectation - too weak
- Outcome disproportionate
 - Disproportionate to whom?
 - How to define/provide guidance on disproportionate
 - How to reconcile with need to disclose in public interest

Task Force Proposal

- Required to disclose if disclosure is in the public interest
- Whether it is in the public interest will depend upon
 - Significance to the entity's financial reporting
 - Extent to which external parties are likely to be affected
 - Likelihood of recurrence

Other factors considered by Task Force

- Existence of whistle-blowing legislation
- Whether the requirement should be different depending on the role of the accountant
- Should member bodies be required to provide more support to members who find themselves in the situation of having to disclose and whether such requirement be included in the SMOs.