

This agenda paper contains a clean copy of the proposed text.

## **Responding to a Suspected Illegal Act**

- 225.1 This section describes the circumstances where a professional accountant in public practice shall or has a right to override the fundamental principle of confidentiality and disclose a suspected illegal act to an appropriate authority. For the purposes of this section, illegal acts comprise acts of omission or commission, intentional or unintentional, committed by a client, or by those charged with governance, management or employees of a client which are contrary to the prevailing laws or regulations. Personal misconduct unrelated to the business activities of the entity is excluded. This section refers to suspected illegal acts because whether a matter constitutes an illegal act is ultimately a matter for legal determination by a court of law.
- 225.2 If a professional accountant in public practice identifies a suspected illegal act, the accountant shall consider whether there are any applicable legal or regulatory requirements governing how the suspected illegal act is to be addressed and, if so, the accountant shall comply with those requirements. When required by law or regulation to disclose a suspected illegal act, for example as a result of anti-money laundering legislation, a professional accountant in public practice shall make the disclosure in compliance with the relevant legal or regulatory requirements and comply with any prohibitions on alerting (“tipping-off”) the client to the pending disclosure.

### *Professional Accountant Providing Professional Services to an Audit Client*

- 225.3 For the purposes of this section, “audit client” is the entity in respect of which a firm conducts an audit engagement and related entities over which the client has direct or indirect control.
- 225.3a If a professional accountant in public practice providing professional services to an audit client of the firm or network firm acquires, or receives, information that leads the accountant to suspect that an illegal act has been committed by the audit client, or by those charged with governance, management or employees of the audit client, the accountant shall take reasonable steps to confirm or dispel that suspicion. In doing so, the professional accountant is expected to apply 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 service for which the accountant was engaged. In taking reasonable steps to confirm or dispel the suspicion, the professional accountant may wish to consult with others within the firm a network firm or a member body. If the professional accountant in public practice is performing a non-audit service for an audit client of the firm or a network firm, the accountant shall consult with the engagement partner for the audit.
- 225.4 If the professional accountant is unable to dispel the suspicion, 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 nature of the act, the circumstances and individuals involved, the likelihood of collusion and the magnitude of the matter. The appropriate level of management is generally at least one level above the person or persons who appear to be involved in the matter.

- 225.5 If, in the accountant's professional judgment, the response to the matter is not appropriate, the professional accountant shall escalate the matter to higher levels of management, within the entity or the group, as appropriate. If the highest level of management has not appropriately addressed the matter, the professional accountant shall discuss the matter with those charged with governance of the entity or the group, as appropriate. In any case the matter shall be discussed with those charged with governance as required by applicable auditing standards.
- 225.6 If the professional accountant has doubts about the integrity or honesty of management or suspects that management is involved in the suspected illegal act, the accountant shall discuss the matter directly with those charged with governance. If the professional accountant has doubts about the integrity or honesty of those charged with governance or suspects that those charged with governance are implicated in the suspected illegal act, the accountant may consider it appropriate to discuss the matter with the relevant professional body on an anonymous basis or with a legal advisor under the protection of legal privilege to assist in determining the appropriate course of action.
- 225.7 When determining if the response to the matter is appropriate the professional accountant shall consider the nature and magnitude of the matter and factors such as whether:
- The matter has been adequately investigated;
  - Remedial action has been taken to address the matter; and
  - Appropriate steps have been taken to reduce the risk of re-occurrence, such as for example, additional controls or training.
- 225.8 If, in the professional accountant's judgment, the response to the matter is not appropriate the accountant shall determine the appropriate course of action, including whether to terminate the professional relationship with the client.
- 225.9 If the professional accountant or the engagement partner for the audit determines that the suspected illegal act is of such consequence that disclosure to an appropriate authority would be in the public interest, there is an appropriate authority to receive the disclosure, and the entity has not disclosed the matter, the accountant or the engagement partner for the audit shall advise the entity that the matter should be disclosed to the appropriate authority.
- 225.10 In making the determination as to whether disclosure would be in the public interest, the professional accountant shall take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances, would be likely to conclude that the suspected illegal act is of such consequence that disclosure would be in the public interest. The determination will require professional judgment and consideration of the nature and magnitude of the matter, including the number of people that could be affected by the suspected illegal act and the extent to which those people could be affected.
- 225.11 An appropriate authority is one with responsibility for such a matter. In many instances, that authority will have the ability to investigate and take action to safeguard the public interest. The appropriate authority to which to disclose the matter will depend on the nature of the suspected

illegal act for example a competition regulator in the case of a suspected cartel arrangement, and a securities regulator in the case of suspected fraudulent financial reporting in a listed entity.

225.12 If the entity has not made an adequate disclosure within a reasonable period of time, after being advised to do so, the professional accountant or the engagement partner for the audit shall disclose the following to the appropriate authority:

- Suspected illegal acts that directly or indirectly affect the client's financial reporting.
- Suspected illegal acts the subject matter of which falls within the expertise of the professional accountant.

225.13 In exceptional circumstances that are not of a commercial or financial nature a professional accountant in public practice is not required, under this section, to disclose the suspected illegal act. Exceptional circumstances would arise where a reasonable and informed third party would conclude that the consequences of disclosure are sufficiently severe to justify not complying with the requirement to disclose, for example where there would be threats to the physical safety of the professional accountant or other individuals. In such cases the accountant shall determine whether to terminate the professional relationship with the client and whether it is appropriate to continue to provide professional services in the particular jurisdiction.

225.14 In determining how to comply with the requirements of this section, including whether to disclose the suspected illegal act to an appropriate authority, and if so, to which authority, the professional accountant may wish to discuss the matter with the relevant professional body on an anonymous basis or with a legal advisor under the protection of professional privilege.

225.15 When making a disclosure to an appropriate authority, and thus overriding the fundamental principle of confidentiality, the professional accountant shall act reasonably, in good faith and exercise caution when making statements and assertions.

*Professional Accountant Providing Professional Services to a non Audit Client*

225.16 If a professional accountant in public practice who performs a professional service for a client that is not an audit client of the firm or of a network firm acquires, or receives, information that leads the accountant to suspect that an illegal act has been committed by the client, or by those charged with governance, management or employees of the client, the professional accountant shall follow the process outlined in paragraphs 225.3 -225.7. If the professional accountant is unable to escalate the matter, the professional accountant shall disclose the matter to the external auditor, if any, to enable the external auditor to escalate the matter.

225.17 If in the professional accountant's judgment, the response to the matter is not appropriate, the accountant shall determine the appropriate course of action, including whether to terminate the professional relationship with the client.

225.18 If the professional accountant determines that the suspected illegal act is of such consequence that disclosure would be in the public interest, there is an appropriate authority to receive the disclosure, and the matter has not been disclosed, the accountant shall advise the entity that the matter should be disclosed to the appropriate authority. If the entity has not made an adequate disclosure within a reasonable period of time, the professional accountant shall disclose the

matter to the external auditor if the accountant has not already done so. In determining whether disclosure would be in the public interest and whether there is an appropriate authority to receive the disclosure, the professional accountant shall follow the guidance in paragraphs 225.10 and 225.11.

- 225.19 If the suspected illegal act relates to the subject matter of the professional services being provided by the professional accountant, and, after having disclosed the matter to the external auditor, in the accountant's professional judgment the response to the matter continues to be not appropriate the accountant has a right to disclose the matter to an appropriate authority. A professional accountant is expected to exercise this right in order to fulfill the accountant's responsibility to act in the public interest. In exceptional circumstances that are not of a commercial or financial nature an accountant would not be expected to exercise this right. Exceptional circumstances would arise where a reasonable and informed third party would conclude that the consequences of disclosure are sufficiently severe to justify not exercising the right to disclose, for example where there would be threats to the physical safety of the professional accountant or other individuals. If the professional accountant does not exercise this right the accountant shall consider whether to terminate the professional relationship with the client.
- 225.20 If the client is an individual and the professional accountant is unable to dispel the suspicion, the accountant shall discuss the matter with the individual. If the client admits to the illegal act the professional accountant shall advise the client to disclose the matter to an appropriate authority, if there is an appropriate authority to receive the disclosure. If the client refuses to disclose the matter, or does not admit to the illegal act, the professional accountant shall determine the appropriate course of action, including whether to terminate the professional relationship with the individual. If the professional accountant determines that the suspected illegal act is of such consequence that disclosure would be in the public interest and the subject matter of the illegal act falls within the expertise of the professional accountant, the accountant has a right to disclose the matter to an appropriate authority. A professional accountant is expected to exercise this right in order to fulfill the accountant's responsibility to act in the public interest. In exceptional circumstances that are not of a commercial or financial nature an accountant would not be expected to exercise this right. Exceptional circumstances would arise where a reasonable and informed third party would conclude that the consequences of disclosure are sufficiently severe to justify not exercising the right to disclose, for example where there would be threats to the physical safety of the professional accountant or other individuals. If the professional accountant does not exercise this right the accountant shall consider whether to terminate the professional relationship with the client.
- 225.21 If the professional accountant does not exercise the right to disclose as discussed in paragraphs 225.19 and 225.20 the accountant shall consider whether to terminate the professional relationship with the client.

*Protection under Legislation*

- 225.22 The professional accountant may wish to seek legal advice to obtain an understanding of any protection afforded by legislation, such as that afforded in some jurisdictions under whistle-

blowing legislation, if the accountant decides to disclose the matter to a party outside of the client.

*Documentation*

225.23 The professional accountant shall document the steps the accountant took to respond to the suspected illegal act. The documentation shall include, the persons consulted, responses received, the disclosure, if any, made to an appropriate authority. If the accountant did not disclose the matter under paragraphs 225.12, 225.19 or 225. 20 the documentation shall also include:

- The rationale for not disclosing;
- If the accountant determined not to terminate the professional relationship with the client, the reason why; and
- If the accountant determined that it was appropriate to continue providing professional services in the particular jurisdiction, the reason why.

## Responding to a Suspected Illegal Act

- 360.1 This section describes the circumstances where a professional accountant in business has a right to override the fundamental principle of confidentiality and disclose a suspected illegal act to an appropriate authority, when there is no applicable law or regulation. For the purposes of this section, illegal acts comprise acts of omission or commission, intentional or unintentional, committed by an employing organization, or by those charged with governance, management or employees of an employing organization which are contrary to the prevailing laws or regulations. Personal misconduct unrelated to the business activities of the entity is excluded. This section refers to suspected illegal acts because whether a matter constitutes an illegal act is ultimately a matter for legal determination by a court of law.
- 360.2 If a professional accountant in business identifies a suspected illegal act, the accountant shall consider whether there are any applicable legal or regulatory requirements governing how the suspected illegal act is to be addressed and, if so, the accountant shall comply with those requirements. When required by law or regulation to disclose a suspected illegal act, a professional accountant in business shall make the disclosure in compliance with the relevant legal or regulatory requirements.
- 360.3 If a professional accountant in business acquires, or receives, information that leads the accountant to suspect that an illegal act has been committed by an employing organization, or by those charged with governance, management or employees of an employing organization, the accountant shall take reasonable steps to confirm or dispel that suspicion. In doing so, the professional accountant is expected to apply 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 activity the accountant is undertaking. In taking reasonable steps to confirm or dispel the suspicion, the professional accountant may wish to consult with others within the organization.
- 360.4 If the professional accountant is unable to dispel the suspicion, 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.
- 360.5 The professional accountant shall generally first disclose a suspected illegal act within the reporting lines of the employing organization by reporting the matter to a superior. If, in the professional accountant's judgment, the response to the matter is not appropriate or the professional accountant suspects that the superior or management is involved in the suspected illegal act, the accountant shall:
- Escalate the matter within the entity, for example with higher levels of management, internal audit, or those charged with governance; or
  - Disclose the matter in accordance with any established mechanism such as an ethics policy.

If the professional accountant is unable to escalate the matter or the professional accountant has doubts about the integrity or honesty of management and there is no established mechanism such as an ethics policy, the professional accountant shall disclose the matter to the external auditor, if any.

360.6 When determining if the response to the matter is appropriate, the professional accountant shall consider the nature and magnitude of the matter and factors such as whether:

- The matter has been adequately investigated;
- Remedial action has been taken to address the matter; and
- Steps have been taken to reduce the risk of re-occurrence, such as for example, additional controls or training.

360.7 If, in the professional accountant's judgment, the response to the matter is not appropriate, the accountant shall determine the appropriate course of action, including whether to resign from the employing organization.

360.8 If the professional accountant determines that the suspected illegal act is of such consequence that disclosure would be in the public interest, there is an appropriate authority to receive the disclosure, and the matter has not been disclosed, the accountant shall advise the employing organization that the matter should be disclosed to the appropriate authority. If the employing organization has not made an adequate disclosure within a reasonable period of time, the professional accountant shall disclose the matter to the external auditor, if the accountant has not already disclosed the matter to the external auditor.

360.9 If, in the professional accountant's professional judgment, the response to the matter is not appropriate, the accountant has a right, to disclose the following to the appropriate authority:

- Suspected illegal acts that directly or indirectly affect the employing organization's financial reporting.
- Suspected illegal acts the subject matter of which falls within the expertise of the professional accountant.

A professional accountant is expected to exercise this right to disclose in order to fulfill the accountant's responsibility to act in the public interest. In exceptional circumstances an accountant would not be expected to exercise this right. Exceptional circumstances would arise where a reasonable and informed third party would conclude that the consequences of disclosure are sufficiently severe to justify not exercising the right to disclose for example, where there would be threats to the physical safety of the professional accountant or other individuals. If the professional accountant does not exercise this right the accountant shall consider whether to resign from the employing organization.

360.11 In making the determination as to whether disclosure would be in the public interest, the professional accountant shall take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances would be likely to conclude that the suspected illegal act is of such consequence that disclosure would be in the public interest. The determination will require professional judgment and consideration of the substance of the matter, the number of people that could be affected by the suspected illegal act and the extent to which those people could be affected.

- 360.12 An appropriate authority is one with responsibility for such a matter. In many instances, that authority will have the ability to investigate and take action to safeguard the public interest. The appropriate authority to which to disclose the matter will depend upon the nature of the suspected illegal act; for example a tax authority in the case of suspected tax evasion and a securities regulator in the case of suspected fraudulent financial reporting in a listed entity.
- 360.13 In determining how to comply with the requirements of this section, including whether to disclose the suspected illegal act to an appropriate authority, and if so to which authority, the professional accountant may wish to discuss the matter with the relevant professional body on an anonymous basis or with a legal advisor under the protection of professional privilege. In addition the professional accountant may wish to seek legal advice to obtain an understanding of any protection afforded by legislation, such as that afforded in some jurisdictions under whistle-blowing legislation, if the accountant decides to disclose the matter to a party outside of the employing organization.
- 360.14 When making a disclosure to an appropriate authority, and thus overriding the fundamental principle of confidentiality, the professional accountant shall act reasonably, in good faith and exercise caution when making statements and assertions.
- 360.15 The professional accountant shall document the steps the accountant took to respond to the suspected illegal act. The documentation shall include the persons consulted, responses received, the disclosure, if any, made to an appropriate authority. If the accountant did not exercise the right to disclose, the documentation shall include:
- The rationale for not disclosing; and
  - If the accountant determined not to resign from the employing organization, the reason why.