

## **This paper will be discussed on the conference call**

This agenda paper contains a complete mark-up from the text presented on the last day of the IESBA meeting in Dublin.

### **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, when there is no applicable law or regulation.~~ provides guidance to a professional accountant in public practice on how to respond when encountering a suspected illegal act in the course of performing a professional service for a client. ~~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.

~~225.3 When there is no applicable law or regulation, 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.~~

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

225.34 If a professional accountant in public practice ~~during an audit engagement or while performing another professional service for an audit client of the firm or a network firm~~ acquires, or receives, information that leads the accountant to suspect that an illegal act has been committed by an audit client of the firm, or by those charged with governance, management or employees of an 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. If the professional accountant in public practice is performing a non-~~assurance-audit~~ service for an audit client of the firm or a network firm, the ~~professional~~-accountant shall consult with the engagement partner for the audit.

225.45 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.

225.56 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.

225.67 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
- 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 ~~all the~~ professional relationships with the client.

~~225.9~~ When determining if the response to the matter is appropriate the professional accountant shall consider factors such as whether:

- ~~• The matter has been adequately investigated;~~
- ~~• Remedial action has been taken to address the matter;~~
- ~~• Steps have been taken to reduce the risk of re-occurrence, such as for example, additional controls or training; and~~
- ~~• The entity has disclosed the matter to an appropriate authority, if any, or intends to do so within a reasonable period of time.~~

225.9~~10~~ If the ~~entity has not disclosed the matter and 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, ~~and~~ 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. ~~If the entity has not made an adequate disclosure within a reasonable period of time, 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.~~

225.10~~1~~ ~~The determination of whether disclosure would be in the public interest will require professional judgment and consideration of the substance of the matter, the number of people that will be potentially affected by the suspected illegal act and the extent to which those people will be potentially affected.~~ 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.

225.1~~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 ~~corrective~~ 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 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.

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~~4~~ In exceptional circumstances a professional accountant in public practice is not required, under this section, to disclose the suspected illegal act if a reasonable and informed third party would conclude that the probable threats to the physical safety of the professional accountant or other individuals are sufficiently severe to outweigh justify not complying with the requirement to the benefits of disclosure. In such cases, ~~if the professional accountant determines not to disclose the suspected illegal act,~~ the accountant shall take the necessary steps determine whether to terminate ~~as soon as practicable all the~~ professional relationships 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 in the course of performing~~ 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 ~~take reasonable steps as outlined in paragraph 225.4 to confirm or dispel that suspicion.~~

~~225.17 If the professional accountant is unable to dispel the suspicion, and if the client is an entity, the accountant shall discuss the matter with the appropriate level of management. If, in the professional accountant's judgment, the response to the matter is not appropriate, the professional accountant shall escalate the matter within the entity, for example with higher levels of management, internal audit or those charged with governance. If the professional accountant is unable to escalate the matter, the~~

professional accountant shall disclose the matter to the external auditor to enable the external auditor to escalate the matter.

225.178 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 ~~all the~~ professional relationships with the client.

~~225.19 When determining if the response to the matter is appropriate the professional accountant shall consider factors such as whether:~~

- ~~• The matter has been adequately investigated;~~
- ~~• Remedial action has been taken to address the matter;~~
- ~~• Steps have been taken to reduce the risk of re-occurrence, such as for example, additional controls or training; and~~
- ~~• The entity has disclosed the matter to an appropriate authority, if any, or intends to do so within a reasonable period of time.~~

225.1820 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 disclosed the matter to the external auditor. 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 is 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. An accountant would not be expected to exercise this right if a reasonable and informed third party would conclude that the probable threats to the physical safety of the professional accountant or other individuals are sufficiently severe to ~~outweigh justify not exercising the right to the benefits of disclosure.~~ If the professional accountant does not exercise this right the accountant shall consider whether to terminate the professional relationship ~~or all professional relationships~~ 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.

225.21 If the professional accountant does not exercise ~~this-the~~ right to disclose as discussed in paragraphs 225.19 and 225.20 the accountant shall consider whether to terminate the professional relationship ~~or all professional relationships~~ 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, ~~and if~~ the accountant did not disclose the matter under paragraphs ~~225.123~~, ~~225.1920~~ or ~~225. 204~~ the documentation shall also include:

~~;~~ The rationale for ~~not doing so~~ not disclosing; and

~~-If the accountant determined not to terminate the professional relationship with the client, the reason why.~~

## Responding to a Suspected Illegal Act

- 360.1 This section ~~describes the circumstances where provides guidance to~~ a professional accountant in business ~~has a right to override the fundamental principle of confidentiality and disclose on how to respond when encountering~~ a suspected illegal act ~~to an appropriate authority, when there is no applicable law or regulation, in the course of undertaking a professional activity<sup>+</sup>~~. ~~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 ~~and comply with any prohibitions on alerting (“tipping off”) the employing organization to the pending disclosure.~~
- ~~360.3 When there is no applicable law or regulation, 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.~~
- 360.34 If a professional accountant in business ~~in the course of performing a professional activity~~ 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.

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<sup>+</sup> ~~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.”~~

360.45 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.

360.56 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 is unable to escalate the matter and there is no established mechanism such as an ethics policy, the professional accountant shall disclose the matter to the external auditor.

~~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.~~

360.86 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; ~~and~~
- ~~• The employing organization has disclosed the matter to an appropriate authority, if any, or intends to do so within a reasonable period of time.~~

~~360.79 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. An accountant would not be expected to exercise this right if a reasonable and informed third party would conclude that the probable threats to the physical safety of the professional accountant or other individuals are sufficiently severe to ~~outweigh justify not exercising~~ the right to benefits of the disclosure. If the professional accountant does not exercise this right the accountant shall consider whether to resign from the employing organization.

~~360.110~~ ~~The determination of whether reporting would be in the public interest will require professional judgment and consideration of the substance of the matter, the number of people that will be potentially affected by the suspected illegal act and the extent to which those people will be potentially affected.~~ 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.

~~360.121~~ An appropriate authority is one with responsibility for such a matter. In many instances, that authority will have the ability to investigate and take ~~corrective~~ 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.

~~360.132~~ 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.

360.1~~4~~<sup>3</sup> 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.

360.1~~5~~<sup>4</sup> 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. ~~and~~ ~~If~~ if the accountant did not exercise the right to disclose, the documentation shall include:

- The rationale for not ~~doing so~~ disclosing; and
- -If the accountant determined not to resign from the employing organization, the reason why.