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Stellungnahme zum Code of Ethics – Exposure Draft Responding to a Suspected Illegal Act

Die Wirtschaftsprüferkammer hat mit Schreiben vom **7. Dezember 2012** gegenüber der International Federation of Accountants (IFAC) zum Code of Ethics – Exposure Draft Responding to a Suspected Illegal Act wie nachfolgend wiedergegeben Stellung genommen:

We are pleased to take this opportunity to comment on the above-mentioned Exposure Draft.

WPK highly appreciates the further development of the Code of Ethics (hereinafter referred to as "CoE") and the corresponding efforts and work of the IESBA over the past years. However, in the light of the demands on the member organizations in terms of implementation and regulation (including translation) resulting from amendments to the CoE, further amendments to the CoE should be carefully considered.

After weighing all positive and negative effects and arguments respectively, we regret being unable to support this project as far as a right or an obligation of the auditor to override confidentiality and to disclose the matter to an external authority is concerned. This would be in conflict with fundamental legal principles and weaken the profession rather than contributing to improving its reputation and growth. We agree on the other hand that the auditor should be required to discuss any findings as to (suspected) illegal acts/fraud with the management and/or supervisory board of the audit client, as already provided in German law.

In the following, we would like to provide you with our considerations. We hereby prefer discussing the issues in a single context since responding to the questions of the Exposure Draft one by one would disrupt the issues.

I. General matters

First of all, we would like to note that we would have wished to learn more about the motivation for this project in the background notes. Although the “public interest” and the issues “suspected fraud” and “illegal acts” are mentioned, the precise grounds remain unclear to us. Of particular interest in this context would be if the project is driven by IESBA itself or by requests of the profession or regulators.

To our state of knowlegde, only few countries do have already a system in place that stipulates an override of confidentiality comparable to that provided for by IESBA. The Explanatory Memorandum does not contain any description in this regard. However, it might be fruitful to learn about the experience of those countries gained in connection with their corresponding regulation. By means of such a process, difficulties, advantages and disadvantages might be identified and discussed in detail as a preparatory step for the decision as to whether such a provision should be implemented into the CoE.

II. Main reasons against an override of confidentiality

When discussing a possible override of confidentiality and justifying it with a public interest, one should bear in mind that confidentiality is a principle that is also in the public interest since it enables the extensive disclosure of facts and circumstances within the relationship of the client and its auditor and therefore contributes to improving the quality of the auditor´s work from which the stakeholders and the public benefit. In contrast, overriding confidentiality runs the risk of creating inappropriate disincentives for the client regarding the disclosure of certain information and circumstances resulting in a decrease of information provided by the client.

Moreover, overriding confidentiality might not only influence the aforementioned relationship of the auditor and the client negatively, but it would probably also be in conflict with a German and European legal principle of utmost importance. According to German law and the jurisdiction of the European Court of Human Rights no one is obliged to incriminate him-/herself (principle of nemo tenetur) and there also exist corresponding utilization prohibitions. When overriding confidentiality as provided for in the Exposure Draft, this would de facto mean that the client would contribute to incriminating him-/herself. The axiom of nemo tenetur has a long-standing tradition

in Europe and is in our view at least as important as the effects reached by overriding confidentiality.

Besides, overriding confidentiality would disrupt the well balanced allocation of responsibilities between the public accountant on the one hand and the client´s management and its supervisory entities on the other hand. The decision as to whether to disclose an illegal act and particularly to carry out corresponding investigations is and should remain a prior-ranking duty of the management and/or its supervisory entities and not the public accountant. In other words, primary tasks of the management and its supervisory entities would be spuriously shifted to the public accountant if an override of confidentiality were set up.

Another crucial aspect is that of liability risks. The profession will face increased exposure to litigation if the suspicion turns out to be unfounded. Albeit this aspect is noted in IESBA´s Impact Assessment published alongside this Exposure Draft, we would have wished this matter to be discussed in the Explanatory Memorandum itself. It is questionable if these additional liability risks are covered by the current professional indemnity insurance or if they would and could be covered in the future. Yet, according to German law, the maintenance of a professional indemnity insurance covering financial damages arising out of the indemnity risks of exercising the profession, is a prerequisite for being authorized to practice as a public accountant (Section 54 Public Accountant Act, WPO). Although new insurance might be offered for the new risks in the future since the insurance industry might react correspondingly, the insurance premiums will certainly rise. This would not be easy to cope with by the profession, particularly for SMPs who already according to the status quo face serious problems regarding the amount of the insurance premiums. Also important to note in this context is that the European Commision issued a Recommendation concerning the limitation of the civil liability of auditors in 2008 (5 June 2008, 2008/473/EC). Its main purpose was to encourage the growth of alternative audit firms in a competitive market and to respond to the increasing trend of litigation and lack of sufficient insurance cover in this sector. Against this background the already exisiting various liablity risks for the audit profession should basically be limited and not further increased. Hence overriding confidentiality would seem to be counterproductive in this regard.

The proposal would require a professional accountant to determinate whether certain suspected illegal acts are of such consequences that disclosure to an appropriate authority would be in the public interest. In our view the precise determination as to whether the disclosure would be in the public interest remains unclear notwithstanding the explanations contained in the Explanatory Memorandum. This assessment is a subjective one and could result in a wide range of con-

clusions and might vary from person to person. Legal uncertainty for the profession would be the consequence.

Besides, we do have doubts if an accountant should be subject to extensive investigation duties as provided for by the Exposure Draft. In our view, such investigations - except for financial reporting issues that will be described in more detail below (III.) - should only be conducted by and subject to (public) criminal and enforcement authorities, respectively.

Also noteworthy is that requirements to disclose illegal acts are normally coupled with whistle-blowing protection mechanisms which can only be set up by the legislator but not by IESBA. Since it remains uncertain if such protection would be established, the isolated implementation of a requirement to disclose illegal acts would basically be disproportionate.

III. Possible statutory override of confidentiality

After having described the main reason against an override of confidentiality, it is to be deliberated in a second step, if they could be overcome due to reasons of higher interest, particularly a public interest.

In our view an override of confidentiality might only be considered if the suspected illegal act directly or indirectly affects the client´s financial reporting in the context of statutory audits. The statutory audit obligation originates from the perception that for certain audits there is a public interest which justifies subjecting certain companies to a corresponding audit requirement. This public interest is also reflected in the fact that to our knowledge the statutory auditor is obliged to undertake investigations in many jurisdictions if there are any indications of illegal acts concerning the financial reporting. It might be consequential to extend this duty to a corresponding reporting requirement towards an external authority. However, as regards the external authority and the corresponding reporting requirement, it is essential that two prerequisites are met: Firstly, the authority shall be **a public authority** since the public interest is concerned. **Secondly, such an authority and the corresponding reporting requirement for the public accountant are to be created and established by the legislator of the jurisdiction concerned to be legitimate and enforceable**. In contrast, the regulation of this matter by IESBA appears to fall outside its competence.

On the other hand, as regards **illegal acts not pertaining to the client´s financial reporting, a reporting requirement would be disproportionate** since there is no public interest that would justify the override of confidentiality. This is especially true when it comes to **voluntary audits** since they are not prescribed by law and are basically considered as “private” and not “public”.

IV. Conclusion

An override of confidentiality might be deemed as appropriate only in exceptional cases. These cases should be limited to illegal acts that pertain to financial reporting in the context of statutory audits. However, such a reporting requirement towards an external authority would have to be set up by the jurisdictions concerned and not by IESBA.

Apart from the aforementioned limited cases, an override of confidentiality would be disproportionate given that the benefit for the public would be relatively small in comparison to the burden for the profession. This is especially true considering the fact that illegal acts and their disclosure by the accountant would probably occur only in few and exceptional cases.