



**Responding to Non-Compliance or Suspected Non-Compliance with
Laws and Regulations**

Proposed amendments to the IAASB's International Standards

RESPONSE FROM ICAS TO THE IAASB

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Background

ICAS welcomes the opportunity to comment on the *Proposed amendments to the IAASB's International Standards on Responding to Non-Compliance or Suspected Non-Compliance with Laws and Regulations*.

Our CA qualification is internationally recognised and respected. We are a professional body for over 20,000 members who work in the UK and in more than 100 countries around the world. Our members represent different sizes of accountancy practice, financial services, industry, the investment community and the public sector. Almost two thirds of our working membership work in business, many leading some of the UK's and the world's great companies.

Our Charter requires its committees to act primarily in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Any enquiries should be addressed to James E Barbour, Director, Technical Policy.

General Observations

Like certain other bodies, we have reservations regarding the due process that has been followed, and the timing implications of the IAASB's proposed amendments to its standards, in relation to IESBA's efforts to finalise its proposed NOCLAR revisions to its Code of Ethics. We would highlight that whilst we believe progress has been made by IESBA in relation to its NOCLAR proposals, these require considerable more work before finalisation. We believe that it would have been prudent and more efficient for IAASB to wait until IESBA had finalised its proposed revisions to the Code of Ethics before considering the effect of the revisions on the ISAs and other assurance standards. There appears to be a presumption that the revised IESBA proposals will be substantively adopted.

One further more general comment, based on feedback received from other EU member states, is to highlight that frequent incremental changes to the ISAs, which require retranslation in some jurisdictions, create a time-consuming and costly administrative burden therefore we would request that a cost benefit approach is adopted to any future limited changes to ISAs.

IAASB Approach

Subject to our overriding comments on the timing, we support:

- IAASB's approach i.e. to only undertake a limited review to ISA 250 and do not support a more thorough review of the standard at this time.
- IAASB's approach to the revision of the standard to align it with the proposed requirements of the IESBA Code: *"The proposed limited amendments do not explicitly duplicate in detail all the specific requirements in the IESBA Code. This allows for flexibility when ethical codes other than the IESBA Code are applied and to minimize the amount of material that would be incorporated into ISA 250 and other of the IAASB's International Standards"*.

Terminology

We question whether replacing the word 'responsibilities' with the term 'legal or ethical duty or right' is appropriate. The absence of a clear definition of a 'legal or ethical duty or right' risks creating some uncertainty or ambiguity in the application of the standard and as such we would prefer to retain the more commonly understood term 'responsibilities'.

Legal Requirements – “Tipping-Off”

We believe that IAASB, as has IESBA, understated the importance of highlighting the need for auditors to be aware of the legal requirements placed on them in relation to the potential offence of “tipping off” in certain jurisdictions. We elaborate on this matter in our detailed responses below.

Detailed responses to the Specific Consultation Questions

Question 1

Whether respondents believe the proposed limited amendments are sufficient to resolve actual or perceived inconsistencies of approach or to clarify and emphasize key aspects of the NOCLAR proposals in the IAASB’s International Standards.

Although we are supportive of the proposed approach to this matter, we question the timing of these proposed revisions. We believe that IAASB should not have commenced this project until IESBA had finalised its revisions to the IESBA Code.

Additionally, we have a number of specific comments in relation to the proposed amendments to ISA 250 and other standards which we have listed below.

ISA 250 Consideration of laws and regulations in an audit of financial statements

Paragraph 11 Definition

“For the purposes of this ISA, the following term has the meaning attributed below:

Non-compliance – Acts of omission or commission by the entity, either intentional or unintentional, which are contrary to the prevailing laws or regulations. Such acts include transactions entered into by, or in the name of, the entity, or on its behalf, by those charged with governance, management or employees. Non-compliance does not include personal misconduct (unrelated to the business activities of the entity) by those charged with governance, management or employees of the entity.”

As we stated in our response to IESBA, the definition does not appear to capture the behaviour of individuals who may be working on a contractual basis on behalf of the organisation but whom are sub-contracted rather than actual employees of the entity. Whilst this may be outside of the proposed scope of the IAASB’s review of the standard, it does relate to our response to IESBA, therefore, we believe should be considered as part of this exercise.

Paragraph 16

“The auditor shall request management and, where appropriate, those charged with governance, to provide written representations that all known instances of non-compliance or suspected noncompliance with laws and regulations whose effects should be considered when preparing financial statements have been disclosed to the auditor. (Ref: Para. A12)”

Whilst we understand the reference to financial statements, we question whether the scope needs to be wider i.e. “annual report” as opposed to “financial statements”.

Paragraph 19

“If the auditor suspects there may be non-compliance, the auditor shall discuss the matter with management and, where appropriate, those charged with governance. If management or, as appropriate, those charged with governance do not provide sufficient information that supports that the entity is in compliance with laws and regulations and, in the auditor’s judgment, the effect of the suspected non-compliance may be material to the financial statements, the auditor shall consider the need to obtain legal advice. (Ref: Para. A15–A16)”

We would suggest that there should be some guidance that refers the auditor to consider the legal and regulatory framework that applies and which serves as a reminder of possible ‘tipping off’ provisions.

Paragraphs 22 - 24

“Unless all of those charged with governance are involved in management of the entity, and therefore are aware of matters involving identified or suspected non-compliance already communicated by the auditor, the auditor shall communicate with those charged with governance matters involving noncompliance with laws and regulations that come to the auditor’s attention during the course of the audit, other than when the matters are clearly inconsequential.

If, in the auditor’s judgment, the non-compliance referred to in paragraph 22 is believed to be intentional and material, the auditor shall communicate the matter to those charged with governance as soon as practicable.

If the auditor suspects that management or those charged with governance are involved in noncompliance, the auditor shall communicate the matter to the next higher level of authority at the entity, if it exists, such as an audit committee or supervisory board. Where no higher authority exists, or if the auditor believes that the communication may not be acted upon or is unsure as to the person to whom to report, the auditor shall consider the need to obtain legal advice.”

As per our comments in relation to paragraph 19, there would appear to be a need to include wording referring the auditor to consider the legal and regulatory framework that applies and which serves as a reminder of possible ‘tipping off’ provisions.

Paragraph 28

“If the auditor has identified or suspects non-compliance with laws and regulations, the auditor shall determine whether the auditor has a responsibility legal or ethical duty or right to report the identified or suspected non-compliance to parties outside the entity.

We do question whether replacing the word ‘responsibilities’ with the term ‘legal or ethical duty or right’ is appropriate. The absence of a clear definition of a ‘legal or ethical duty or right’ risks creating some uncertainty or ambiguity in the application of the standard and as such we would prefer to retain the more commonly understood term ‘responsibilities’.

Paragraph A5a

“Examples of laws and regulations that may be included in the categories described in paragraph 6 include those that deal with:

- *Fraud, corruption and bribery.*
- *Money laundering, terrorist financing and proceeds of crime.*
- *Securities markets and trading.*
- *Banking and other financial products and services.*
- *Tax and pension liabilities and payments.*
- *Environmental protection.*
- *Public health and safety.”*

It is not immediately clear why the category of ‘Securities, markets and trading’ is included. This may be viewed as an artificial means of seeking to bring ‘insider trading’ within the locus of ISA 250. We believe that this artificial construction is not appropriate and have informed IESBA accordingly. Additionally, in the context of the audit profession, this reference may just serve to create unrealistic expectations in this context.

Paragraph A15

“The auditor may discuss the findings with those charged with governance where they may be able to provide additional audit evidence. For example, the auditor may confirm that those charged with governance have the same understanding of the facts and circumstances relevant to transactions or events that have led to the possibility of non-compliance with laws and regulations. However, in some jurisdictions, laws or regulations may prohibit alerting (“tipping-off”) the entity when, for example, the auditor is required to report the non-compliance to an appropriate authority pursuant to anti-money laundering legislation.”

We believe that the ‘tipping off’ reference should come first in this paragraph as the ‘tipping off’ consideration is overarching. The same comment applies to paragraph A17.

We note that that the scope of paragraph A17 also stops at employees. We would suggest that, where sub-contractors are performing employee tasks, then they should also be captured within the scope of the ISA.

Paragraph A19

“If the auditor has identified or suspects non-compliance with laws or regulations, the auditor may consider obtaining legal advice to determine whether the auditor has a legal or ethical duty or right to report to parties outside the entity and, when applicable, the appropriate course of action in light of such duty or right. For example

- *The duty of confidentiality may not apply or may be overridden by laws or regulations. In some jurisdictions, the auditor of a financial institution has a statutory duty to report the occurrence, or suspected occurrence, of non-compliance with laws and regulations to supervisory authorities. Also, in some jurisdictions, the auditor has a duty to report misstatements to authorities in those cases where management and, where applicable, those charged with governance fail to take corrective action.*
- *The auditor may have the right to disclose identified or suspected non-compliance with laws or regulations to an appropriate authority without breaching the duty of confidentiality.*
- *The auditor’s legal or ethical duties to maintain confidentiality may preclude reporting identified or suspected non-compliance with laws and regulations to a party outside the entity.”*

As mentioned earlier, we question whether replacing the word ‘responsibilities’ with the term ‘legal or ethical duty or right’ is appropriate. The absence of a clear definition of a ‘legal or ethical duty or right’ risks creating some uncertainty or ambiguity in the application of the standard and as such we would prefer to retain the more commonly understood term ‘responsibilities’.

ISQC 1 Quality control for firms that perform audits and reviews of financial statements, and other assurance and related services engagements requirements

Application and Other Explanatory Material A56 -Relevant ethical requirements establish an obligation for the firm’s personnel to observe at all times the confidentiality of information contained in engagement documentation, unless specific client authority has been given to disclose information, or there is a legal or professional ethical duty or right to do so. In certain circumstances, the firm’s personnel may have the legal or ethical right to disclose identified or suspected non-compliance with laws or regulations to an appropriate authority without breaching the duty of confidentiality.¹⁷ Specific laws or regulations may impose additional obligations on the firm’s personnel to maintain client confidentiality, particularly where data of a personal nature are concerned.

Please see earlier comments regarding the replacement of ‘responsibilities’ with the term ‘legal or professional ethical duty or right’.

ISA 240 The auditor’s responsibilities relating to fraud in an audit of financial statements

Paragraph 40

“If the auditor has identified a fraud or has obtained information that indicates that a fraud may exist, the auditor shall communicate these matters on a timely basis to the appropriate level of management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities. (Ref: Para. A60)”

We believe that the ‘tipping off’ material should be given greater prominence and therefore should be placed in the requirements section as opposed to the explanatory material.

Paragraph 43

“If the auditor has identified or suspects a fraud, the auditor shall determine whether there is a responsibility to report the occurrence or suspicion to a party outside the entity. Although the auditor’s professional duty and relevant ethical requirements regarding to maintaining the confidentiality of client information may preclude such reporting, in some circumstances the auditor’s legal responsibilities may override the duty of confidentiality may not apply, be overridden by laws or regulations, or include a duty or right to report to an appropriate authority in some circumstances. (Ref: Para. A65–A67)”

Please see earlier comments regarding the replacement of ‘responsibilities’ with the term ‘legal or professional ethical duty or right’.

Paragraph A59a

“In some jurisdictions, laws or regulations may prohibit alerting (“tipping off”) the entity when, for example, the auditor is required to report the non-compliance to an appropriate authority pursuant to anti-money laundering legislation.”

As highlighted in our earlier comment on paragraph 40, we believe that this content should also be given greater prominence and should be placed in the requirements section.

Paragraph A65

“The auditor’s professional duty to maintain the confidentiality of client information may preclude reporting fraud or other identified or suspected non-compliance with laws or regulations to a party outside the client entity. However, the auditor’s legal responsibilities vary by country and, in certain circumstances, the duty of confidentiality may be overridden by statute, the law or courts of law, laws or regulations. Law, regulation, or relevant ethical requirements may include a duty or right to report to an appropriate authority. In some countries, the auditor of a financial institution has a statutory duty to report the occurrence of fraud to supervisory authorities. Also, in some countries the auditor has a duty to report misstatements to authorities in those cases where management and those charged with governance fail to take corrective action. In certain circumstances, the auditor may have the right to disclose identified or suspected non-compliance with laws or regulations to an appropriate authority without breaching the duty of confidentiality.”

Please see earlier comments regarding the replacement of ‘responsibilities’ with the term ‘legal or professional ethical duty or right’.

ISA 260 (Revised), Communication with Those Charged with Governance Introduction - The Role of Communication

Paragraph 7

“Law or regulation may restrict the auditor’s communication of certain matters with those charged with governance. For example, laws or regulations may specifically prohibit a communication, or other action, that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act, including alerting (“tipping-off”) the entity when, for example, the auditor is required to report the non-compliance to an appropriate authority pursuant to anti-money laundering legislation. In some circumstances, potential conflicts between the auditor’s obligations of confidentiality and obligations to communicate may be complex. In such cases, the auditor may consider obtaining legal advice.”

We welcome this approach - to include the ‘tipping off’ reference upfront at the start of the standard. We would suggest a similar approach is adopted within the other ISAs as per our earlier comments.

Paragraph A8

“Law or regulation may restrict the auditor’s communication of certain misstatements to management, or others, within the entity. For example, laws or regulations may specifically prohibit a communication, or other action, that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act, including alerting (“tipping-off”) the entity when, for example, the auditor is required to report the non-compliance to an appropriate authority pursuant to anti-money laundering legislation. In some circumstances, potential conflicts between the auditor’s obligations of confidentiality and obligations to communicate may be complex. In such cases, the auditor may consider seeking legal advice.”

As highlighted in our earlier comments, we believe that this content should also be given greater prominence and should be placed in the requirements section.

ISRE 2400 (Revised), Engagements to Review Historical Financial Statements

Paragraph A92

“Under this ISRE, if the practitioner has identified or suspects fraud or illegal acts, the practitioner is required to determine whether there is a responsibility to report the occurrence or suspicion to a party outside the entity. The practitioner’s ethical, legal, and regulatory responsibilities vary by jurisdiction and, in certain circumstances, the duty of confidentiality may not apply, be overridden by laws or regulations or law, regulation, or relevant ethical requirements may include a duty or right to report to an appropriate authority. In certain circumstances, the practitioner may have the legal or ethical right to disclose identified or suspected non-compliance with laws or regulations to an appropriate authority without breaching the duty of confidentiality. However, in other cases, the practitioner’s legal or ethical duties to maintain confidentiality may preclude reporting identified or suspected noncompliance with laws and regulations to a party outside the entity. Although the practitioner’s professional duty to maintain the confidentiality of client information may preclude such reporting, the practitioner’s legal responsibilities may override the duty of confidentiality in some circumstances.

As highlighted in our earlier comments, we believe that this content should also be given greater prominence and should be placed in the requirements section.

ISAE 3402, Assurance Reports on Controls at a Service Organization Requirements

Paragraph 56

“If the service auditor becomes aware of non-compliance with laws and regulations, fraud, or uncorrected errors attributable to the service organization that are not clearly trivial and may affect one or more user entities, the service auditor shall determine whether the matter has been communicated appropriately to affected user entities. If the matter has not been so communicated and the service organization is unwilling to do so, the service auditor shall take appropriate action. (Ref: Para. A53) Application and Other Explanatory Material Other Communication Responsibilities (Ref: Para. 56) A53. Appropriate actions to respond to the circumstances identified in paragraph 56 may include: • Obtaining legal advice about the consequences of different courses of action. • Communicating with those charged with governance of the service organization. • Communicating with third parties (for example, a regulator) when required the auditor has a duty or right to do so. • Modifying the service auditor’s opinion, or adding an Other Matter paragraph. • Withdrawing from the engagement.”

As highlighted in our earlier comments, we believe that this content should also be given greater prominence and should be placed in the requirements section.

Once again, please see earlier comments regarding the replacement of ‘responsibilities’ with the term ‘legal or professional ethical duty or right’.

Question 2

The impact, if any, of the proposed limited amendments in jurisdictions that have not adopted, or do not plan to adopt, the IESBA Code. For example, would any of the changes to the IAASB’s International Standards be deemed incompatible with the relevant ethical requirements that would apply in those jurisdictions?

We would highlight that, for jurisdictions that have not adopted the IESBA Code, there might be an issue regarding their compliance with the ISAs if certain aspects of the IESBA code are included within the ISAs. This is unlikely to have a major impact on larger firms who are part of an international network, but, for individual firms, or sole practitioners, the impact could be significant.

Question 3

In addition to the requests for specific comments above, we make the following comments on more general matters:

(c) Translations

As stated in the introductory paragraphs to our response, we are concerned that frequent incremental changes to the ISAs, which require retranslation in some jurisdictions, create a time-consuming and costly administrative burden therefore we would request that a cost benefit approach is adopted to any future limited changes to ISAs.

(d) Effective Date—it is anticipated that the effective date of the amendments to the IAASB's International Standards would be aligned with the effective date of the NOCLAR standards, which the IESBA will determine in due course. Invitation for Additional Input.

We believe that it is important that the effective date of the amendments to the IAASB's International Standards is aligned with the effective date of the NOCLAR standards but would reiterate our comments, in the introductory paragraphs, regarding the due process that has been followed and the timing implications of both projects.

Question 4

Consultations undertaken as part of developing the IAASB's current Strategy and Work Plan had not demonstrated that ISA 250 warranted immediate revision, particularly in light of the other projects that the IAASB was asked to prioritize in the public interest. The IAASB was of the view that this Explanatory Memorandum could be a vehicle for soliciting stakeholders' views as to whether there is merit in exploring other aspects of ISA 250 where further improvements may need to be considered in due course (i.e., under a future IAASB Work Plan).

We agree with the IAASB's approach, to propose only limited amendments to ISA 250 at this stage, but reiterate our comments in response to question 3 (c) regarding the time and cost burden associated with translating and applying frequent limited revisions to the ISAs.