October 15. 2015

IAASB

Ref: ED Responding to Non-Compliance or Suspected Non-Compliance with Laws and Regulations

FSR - danske revisorer welcomes this project to ensure consistency between ISAs and the IESBA's Code. In our view this should not result in significant changes to the ISAs.
We have responded to the IESBA ED on NOCLAR, and we attach this response as an Appendix to this letter. In order to contextualise our view on the fundamentals of the NOCLAR proposals, we kindly request that this comment letter is considered in conjunction to the one to the IESBA ED on NOCLAR. Our view is sceptical as to benefits and necessity of the IESBA project, cf. the citation below:

> "In principle, though, we are of the opinion that the issues in the IESBA ED should be addressed primarily by legislation. Such legislation should be promoted by international institutions like G20, IOSCO and the European Commission besides national authorities in the same way as protective measures against money laundering and financing of terrorism. In contrast to such measures, the Code of Ethics is not a legal instrument.
> Therefore, the Code of Ethics can not provide protection e.g. against lawsuits from clients, which might be injured by the auditor's reporting of secrecies to the authorities. Such protection should be in place, especially because the reporting is not only dealing with ascertainable facts, but (also) regarding suspicion of illegal acts."

We refer to our specific comments under the assumption that the projects are viable.

Kind regards

Lisbeth Kjersgaard
Chief Consultant
Secretary of the Audit Committee
FSR-danske Revisorer

Lars Kiertzner
Chief Consultant
Secretary of the Ethics Committee
FSR-danske revisorer

Specific comments

12 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.

The auditor has indeed the responsibility to report NOCLAR to an appropriate authority. This is described accurately in the revised paragraph A19 of ISA 250. However, we question whether the revision of paragraph A19 is necessary since reporting requirements for auditors to relevant authorities stem from laws and regulations that overrule the fundamental principle of confidentiality.

We do not think that the IAASB's proposal to change the word "responsibilities" to read "legal or ethical duty or right" is the right approach. We question what an "ethical right" means (paragraph 11 (a) of the introduction). We are of the view that determining whether to disclose a matter to an appropriate authority, and as such break client confidentiality, is a matter for legislation, and not for international standard setters to define.

We do agree with the changes that impact the auditor's evaluation of management integrity.

13 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 do not consider this relevant in a Danish context, since we have adopted the Code.

17 On balance, the IAASB did not believe it is necessary at this time to further explore these areas or to undertake a more fulsome revision of ISA 250. Developing these additional changes could prolong the finalization of the proposed changes to the IAASB's International Standards and could have unintended consequences in circumstances where ethical codes other than the IESBA Code are applied. Finally, the IAASB also noted that its Work Program 2015–2016 is unlikely to be able to accommodate a project to more fully revise ISA 250 without delaying or deferring other projects that received broad support when the IAASB consulted on its Strategy for 2015–2019. Accordingly, the IAASB will continue with the limited amendments as proposed in this ED.

We agree.

APPENDIX

FSR-danske revisorer comments on IESBA Exposure Draft: Compliance with Laws and Regulations"

IESBA Technical Director
Mr. Ken Siong

By e-mail: kensiong@ethicsboard.org

September 2015

Re: FSR-danske revisorer comments on IESBA Exposure Draft: "Responding to Non-Compliance with Laws and Regulations"

Dear Mr. Siong

The Ethics Committee of FSR - danske revisorer is pleased to comment on the IESBA Consultation Paper, Responding to Non-Compliance with Laws and Regulations. The revised ED is a significant improvement of the previous draft. It has gone some way to finding the right balance between responding to stakeholders' expectations and complying with the applicable legal framework.

In principle, though, we are of the opinion that the issues in the ED should be addressed primarily by legislation. Such legislation should be promoted by international institutions like G20, IOSCO and the European Commission besides national authorities in the same way as protective measures against money laundering and financing of terrorism. In contrast to such measures, the Code of Ethics is not a legal instrument.
Therefore, the Code of Ethics can not provide protection e.g. against lawsuits from clients, which might be injured by the auditor's reporting of secrecies to the authorities. Such protection should be in place, especially because the reporting is not only dealing with ascertainable facts, but (also) regarding suspicion of illegal acts.

Besides this general point of view, we have some major concerns in the ED as it is:

- We agree with IESBA that the Code cannot override laws and regulations. Section 225 rightly clarifies that disclosure will be precluded if it is contrary with laws and regulations. In this respect however, the ED does not address how to deal with situations with respect to cross-border engagements, including group audit situations. and this aspect need to be looked further into.

- We are pleased that mandatory reporting is no longer being considered, as this would have resulted in unintended and adverse consequences, potentially reducing the ability of PAs to influence potential non-compliance. However, we remain concerned, as the proposals could still create a "de facto" requirement in certain extreme circumstances and also introduce uncertainty surrounding the question of when and what PAs might disclose to an external authority.

- We fully subscribe to the objectives and requirements already included in the International Standard of Auditing (ISA) 250 on "Consideration of Laws and Regulations in an Audit of Financial Statements" which includes having to respond appropriately to non-compliance or suspected non-compliance with laws and regulations identified during the audit.
  We are therefore duly following the new project initiated by the IAASB to ensure that the Code and the ISA 250 are fully compatible.
  Both independent boards should nonetheless be cautious not to go far beyond extant ISA 250. It should be foreseen that auditors break client confidentiality when it is already provided for within the applicable laws and regulations of their jurisdiction – neither the IESBA nor ISA 250 can impose any duty on PAs to go beyond national requirements. In Europe, this means national laws and Article 7 of the new audit regulation governing Public Interest Entity (PIE) audits.
- In terms of broader considerations, we do support frameworks and initiatives in relation to PAs' duty to "act in the public interest".
  However, this is a complicated and subjective matter and it does not seem that the intended purpose is achieved. We would like to highlight that there is no clear definition and common understanding of "public interest". Subjective and cultural differences are not dealt with in a Code with an international remit, and an attempt could lead to inconsistent application.

We refer to our specific comments.

Kind Regards,

Lars Kiertzner
Chief Consultant, State Authorized Public Accountant
Secretary of the Ethics Committee, FSR - danske revisorer

Specific comments

General matters

Question 1. Where law or regulation requires the reporting of identified or suspected NOCLAR to an appropriate authority, do respondents believe the guidance in the proposals would support the implementation and application of the legal or regulatory requirement?

Providing guidance to PAs on how they may react in instances of NOCLAR, or suspected NOCLAR, was the intention of the original project proposal. We support guidance to implement and apply the legal and regulatory requirements – but this is primarily a matter to be dealt with in a given jurisdiction. The ESBA Code should not override national law, and should be applied without prejudice to any applicable legal provisions in any jurisdiction conferring a right to override confidentiality.

We are pleased that mandatory reporting is no longer being considered, as this would have resulted in unintended and adverse consequences, potentially reducing the ability of PAs to influence potential non-compliance. We are also pleased that disclosure is precluded where there is a conflict with local laws and regulations, an example being tipping-off concerns under anti-money laundering (AML) legislation where a discussion with management or those charged with governance in a Danish jurisdiction is not lawfully appropriate.

Question 2. Where there is no legal or regulatory requirement to report identified or suspected NOCLAR to an appropriate authority, do respondents believe the proposals would be helpful in guiding PAs in fulfilling their responsibility to act in the public interest in the circumstances?

We recognise the importance of the public interest for the credibility of the accountancy profession. However, IESBA should be aware that there is no clear definition and common understanding of "public interest". Care should be taken to avoid the phrase being used as a way of extending general law enforcement responsibilities to the profession.

As an example, in paragraph 50 onwards, IESBA acknowledges that "public interest" is "too broad and vague" as a threshold. In section 225.4, IESBA nonetheless tries to determine what constitutes the public interest, and in 225.25 the "third party test", which is already a proxy, refers to the broad and vague concept of public interest as the benchmark for the PA's judgement.

In the absence of robust criteria, we are concerned that requiring the individual professional accountant to determine whether the reporting of a particular individual suspected illegal act is or is not in the public interest will lead to inconsistent application.
Subjective and cultural differences can not be properly dealt with in a global Code. An attempt to do so will lead to inconsistent application and prove unworkable.

Question 3. The Board invites comments from preparers (including TCWG), users of financial statements (including regulators and investors) and other respondents on the practical aspects of the proposals, particularly their impact on the relationships between:

a. Auditors and audited entities;

b. Other PAs in public practice and their clients; and

c. PAIBs and their employing organizations.

This question is addressed to specific other stakeholders, and for this reason we give no response.

Specific matters

Question 4. Do respondents agree with the proposed objectives for all categories of PAs?

We are broadly supportive of the proposed objectives for all categories of PAs as set out in 225.3. Whilst we agree in principle with the intention of "(c) To take further action as may be needed in the public interest", we are concerned that this sentence may be too wide, and be responded to with divergent interpretations, see our comments on question 2.

Question 5. Do respondents agree with the scope of laws and regulations covered by the proposed Sections 225 and 360?

ISA 250 has formed the basis for the scope of laws and regulations covered in Sections 252 and 360. Recognising that there is an expectation for the auditor to be knowledgeable in this respect, through being familiar with the relevant ISAs, makes for a balanced approach, but only to some extent: In particular, the Code should reflect the inherent limitations in ISA 250.05 in order to inform public expectations about the ability of the auditor to react to NOCLAR. In addition, the risk-based approach in ISA may not be sufficiently clear in the Code.
Furthermore, we identify the following sentence in the Sections 225.29, 225.45 and 360.28 as dangerous: "If the professional accountant determines that disclosure of the matter to an appropriate authority is an appropriate course of action in the circumstances, this will not be considered a breach of the duty of confidentiality under Section 140 of the Code". This could lead to overlooking that disclosure could be against national law, or precluded under the engagement terms in contractual agreements with clients etc. As such, one might not be aware upon reading the Code that disclosure would potentially be a breach of national law.
We retain our previously stated position that national laws and regulations, and not IESBA, should deal with breaking auditor's client confidentiality.

Question 6. Do respondents agree with the differential approach among the four categories of PAs regarding responding to identified or suspected NOCLAR?

We are broadly supportive of the proposed categories of PAs and the guidance provided for each of those categories.
In particular, we agree with the proposed scope of NOCLAR for PAs other than auditors. For these PAs, any ability to identify NOCLAR is linked to the nature and scope of their individual roles in the organisation, which can be very narrow and limited. This could be made clearer in the proposal.
Regarding PAIBs specifically, their role and the responsibility that comes with it are factors that influence what the public expects them to do. The higher the position in the organisation, the more authority and

the more possibilities one has to escalate a NOCLAR, or suspected NOCLAR. Therefore, it is plausible to have higher expectations of the actions of a senior PAIB than a non-senior PAIB. However, we can foresee difficulties in distinguishing "Senior PAIB" (director, officer or senior employee capable of exerting significant influence) from "Other PAIB" which may have regulatory implications in the future.

Question 7. With respect to auditors and senior PAIBs:

(a) Do respondents agree with the factors to consider in determining the need for, and the nature and extent of, further action, including the threshold of credible evidence of substantial harm as one of those factors?

We find that the factors need to be revised further to avoid uncertainty in their interpretation. The interaction between the factors also needs to be considered in order to ensure that the required determination is not disproportionate and unnecessarily complex.

For example, "urgency of the matter" is not always clearly discernible, and what degree of urgency would be that would "cross the threshold". Some examples of "serious adverse consequences" would be useful, as well as a clarification as to whether a material misstatement would always necessarily have "severe adverse consequences".

We suggest that IESBA explicitly makes reference to instances where there is no credible evidence but only a suspicion of NOCLAR, and as such refer to the steps which a PA would be anticipated to follow in assessing the potential consequences (for example reputational damage) of any action taken. In that case, the risk of an incorrect assessment of the situation is more probable and could have severe consequences.

(b) Do respondents agree with the imposition of the third party test relative to the determination of the need for, and nature and extent of, further action?

The interpretation of what is deemed to be a 'reasonable and informed third party' is subjective as is the term "acting in the public interest".

Subjective and cultural differences cannot be properly dealt within an international Code, and an attempt to do so will lead to inconsistent application and render the provisions of the Code unworkable. We are not comfortable with the fact that the "third party test", which is already a proxy by itself, refers to the broad and vague concept of public interest as the benchmark for the PA's judgement. Subjectivity will always remain a factor in the assessment, and interpretation will vary in different jurisdictions. What a reasonable and informed third party expects a PA to do, depends on facts and circumstances, culture, the general ethical views at that time, and one's role and position.

(c) Do respondents agree with the examples of possible courses of further action? Are there other possible courses of further action respondents believe should be specified?

We agree that the examples of possible courses of action provide reasonable guidance

(d) Do respondents support the list of factors to consider in determining whether to disclose the matter to an appropriate authority?

Providing guidance to PAs on how they may react in instances of NOCLAR, or suspected NOCLAR, was the intention of the original project proposal. We are of the view that breaching client confidentiality is a matter for legislation, and not for an international Ethics Code. We agree, though, that a list of factors may be useful to PAs in deciding whether there is a need to terminate a relationship with a client or employer..

However, it should be explicitly stated that this list of factors in determining whether to disclose the matter should serve as generic guidance, but should not be treated as an exhaustive list that would replace professional judgement in the context of law and regulation in the specific jurisdiction.

Question 8. For PAs in public practice providing services other than audits, do respondents agree with the proposed level of obligation with respect to communicating the matter to a network firm where the client is also an audit client of the network firm?

Whilst auditors can be seen as being entrusted with a public interest role when performing audits, and it can be argued that PA also have this role when providing non audit services to their audit clients, it is difficult to justify a disclosure requirement in connection with the provision of non-audit services to non-audit clients. The latter is a contractual arrangement for which it would be difficult to argue that the "public interest" consideration would have equal weight to that of an audit engagement.

There is no explicit requirement to disclose the information to the auditor of a network firm. This seems to be a proportionate solution to deal with confidentiality and privacy laws. However, the ED does not address how to deal with situations connected to cross-border engagements, including group audits. This is particularly problematic in jurisdictions with laws of extraterritorial outreach (e.g. FCPA, UK Bribery Act, etc.).

Question 9. Do respondents agree with the approach to documentation with respect to the four categories of PAs?

We agree with the proportionate approach taken to documentation, where auditors are required to document and other PAs in public practice, as well as PAIBs are encouraged to do so.