

Meeting: IESBA CAG
Meeting Location: New York
Meeting Date: September 10-11 2013

Agenda Item

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Responding to a Suspected Illegal Act – Report-Back and Issues

Objectives of Agenda Item

1. To provide a report-back on proposals of CAG Representatives on this project as discussed at the April 2013 CAG Meeting.
2. To obtain CAG Representatives' views on a straw man of a proposed way forward in the light of comments on the Exposure Draft (ED), *Responding to a Suspected Illegal Act*.

Project Status and Timeline

3. At its March 2013 meeting, the IESBA considered the significant comments received on the ED and a straw man outline of an alternative to the approach set out in the ED regarding a professional accountant's (PA) responsibilities when encountering a suspected illegal act (SIA). The CAG also considered at its April 2013 meeting the significant comments received on the ED and provided initial reactions to the straw man outline.
4. At its June 2013 meeting, the IESBA considered the detailed straw man proposals. The IESBA asked the Task Force to further reflect on a number of aspects of the straw man and to present revised proposals for consideration at the September 2013 IESBA meeting.
5. The Appendix to this paper provides a project history, including links to the relevant CAG documentation.

April 2013 CAG Discussion

6. Below are extracts from the draft minutes of the April 2013 CAG meeting,¹ and an indication of how the project Task Force or IESBA has responded to CAG Representatives' comments.

Representatives' Comments	Task Force/IESBA Response
REQUIREMENT TO DISCLOSE A SIA TO AN APPROPRIATE AUTHORITY	
Mr. Peyret was of the view that the proposed requirement should remain unchanged. He noted that in France, there is a law addressing the reporting of SIAs. Lawyers are required to follow up on SIAs and report them to the appropriate	Mr. Franchini clarified that respondents were generally not fundamentally opposed to the concept of PAs reporting SIAs to an appropriate authority. Rather, respondents' main concern is that the Code is not the right place to address such an obligation

¹ The minutes will be approved at the September 2013 IESBA CAG meeting.

Representatives' Comments	Task Force/IESBA Response
<p>national authority (TRACFIN). Auditors are part of this information chain, much as internal control is everyone's responsibility.</p>	<p>due to the potential for conflicts with national regulations regarding confidentiality and privacy, and the desirability for any requirement to be coupled with whistle-blowing protection. Accordingly, such respondents believe that the obligation should be established at the national level. A number of respondents have therefore suggested that IFAC stimulate debate on the issue internationally and encourage the development of appropriate national legal frameworks with suitable protections for whistle-blowers.</p>
<p>Ms. de Beer was of the view that ultimately, one must consider what is in the public interest. She felt that while there are strong arguments against imposing such an obligation on professional accountants in business (PAIBs), for auditors it is not an issue that cannot be overcome. She added that it would be fundamentally wrong for the IESBA to back away from the proposal because of the objections. Rather, she felt the IESBA should explore how the practicalities of the proposal could be addressed.</p>	<p>Point noted. The Task Force and IESBA have been further exploring the possibilities with respect to disclosure in the case of audits of public interest entities (PIEs) in circumstances where law or regulation affords protection for disclosure. See discussion under Issue E below.</p>
<p>Mr. Finnell agreed with Ms. de Beer. However, he noted that it is also in the public interest for there to be a strong and viable profession. He felt that the practical issues, such as the potentially adverse consequences of the proposal on client relationships, would create significant strain on the profession. He also felt that there would be the potential for less ethical auditors to pick up clients that may be engaging in SIAs.</p>	<p>Point not fully accepted.</p> <p>The Task Force noted that while this issue may arise for non-auditors, this may not necessarily be the case for auditors. This is because in a number of jurisdictions, a disclosure requirement for auditors has already existed for a number of years without detriment to the client relationship.</p>
<p>Mr. Morris shared Ms. de Beer's views. He was of the view that it would be difficult for the IESBA to be silent on the matter. He felt that the problem was the attempt by the IESBA to establish the requirement at a global level. He suggested breaking down the issues into distinct parts as a means of simplification, for example, whether it would be in the public interest for auditors of PIEs to address SIAs. He was of the view that addressing all the issues in one sweeping</p>	<p>Point noted. See response to Ms. de Beer's comment above.</p>

Representatives' Comments	Task Force/IESBA Response
document was too ambitious.	
Mr. Fleck noted that the difficulty is the imposition of the obligation to disclose. He asked for views as to whether this should be a requirement or a right. Mr. Peyret highlighted the situation in France with respect to lawyers, who are required to report to the bar. He was of the view that a similar requirement could be established for PAs, for example, reporting internally within the firm. Otherwise, he felt nothing would be done. Ms. de Beer stood by her earlier remarks regarding focusing on what would be in the public interest. However, she suggested that taking smaller steps might help, for example, focusing on PIE audits, as opposed to addressing all possible circumstances at the same time.	Ditto.
Commenting on the issue of legal protections, Mr. Finnell noted that in the U.S. there are insufficient safeguards for PAs. However, he was of the view that the IESBA could leave the decision as to whether to disclose to the auditor's judgment. Many of the practical issues arose because of the proposal to impose the obligation to disclose without legal protections.	Ditto.
Mr. Koktvedgaard commented that the problem is about creating the right incentive. He did not feel the issues could be addressed by focusing on PIE audits only. He believed that the issue is how to create the right standard so that it establishes a very strong incentive to disclose. He suggested considering the approach taken by the International Auditing and Assurance Standards Board (IAASB) in its current project to revise ISA 700, ² i.e., specifying the applicable requirement (the pressure) unless national laws or regulations state otherwise. He felt that such an approach would allow jurisdictions to be aligned with the Code.	Point noted. The IESBA continues to explore the alternatives, taking into account the concerns raised on exposure. See also discussion under Issue E below.

² ISA 700, *Forming an Opinion and Reporting on Financial Statements*

Representatives' Comments	Task Force/IESBA Response
<p>Mr. Hansen was of the view that the appropriate way forward is to align the Code as closely to national requirements as possible so that the Code reinforces the national requirements as opposed to contradicting them. He agreed that it would not be in the public interest for the PA to hide behind the veil of confidentiality. Mr. Fleck was of the view that the issue goes beyond that, as in many jurisdictions there are no national requirements addressing confidentiality or the reporting of SIAs.</p>	<p>Point taken into account.</p> <p>The straw man makes clear that where there are legal or regulatory requirements for disclosure to an appropriate authority, the PA's first responsibility is to comply with those requirements.</p> <p>Where the Code conflicts with legal or regulatory requirements, the latter always prevail because the Code cannot override law or regulation.</p>
<p>Mr. James echoed Mr. Hansen's views. He noted that IOSCO's initial concern had been that if the PA comes across a SIA, the Code should not impede the PA's ability to disclose the SIA if the PA wishes to do so. He was of the view that the Code's current requirements addressing confidentiality do act as an impediment in this regard.</p>	<p>Mr. Franchini explained that the IESBA is endeavoring to create an environment where the PA is encouraged to disclose. He noted that the IESBA had already been aware of IOSCO's comment early in the project. The issue, however, was not how the PA should report but whether he or she should be required to do so.</p>
<p>Mr. Grund asked how confident the IESBA would be that disclosure would be made if a PA ever came across a SIA.</p>	<p>Mr. Franchini explained that the IESBA is aiming to create an environment where the PA is permitted to disclose. He noted that if there were no requirement, this would suggest less disclosure. However, he pointed out that several other factors are also relevant, for example, the availability of legal protection, the PA's strength of conviction, etc. So a number of factors could conspire to discourage reporting. He noted that this point had been made in the explanatory memorandum to the ED.</p>
<p>In reference to Mr. Grund's question, Ms. Blomme was of the view that there are definitely circumstances where it is in the PA's interest to disclose. She expressed support for the alternative approach of providing guidance to help the PA deal with SIAs.</p>	<p>Support noted.</p>
<p>Mr. Fleck expressed the view that it might help if the IESBA took the approach of establishing a right to disclose, supplemented with illustrative guidance. He noted that the difficulty is related to understanding where to draw the line. He</p>	<p>Point accepted. The IESBA is exploring an alternative approach of establishing a general permission to override confidentiality, supplemented with enhanced guidance. See further discussion in</p>

Representatives' Comments	Task Force/IESBA Response
<p>suggested, for example, that most PAs would see disclosing a cartel arrangement to an appropriate authority as being in the public interest. Accordingly, he felt that the challenge is whether the IESBA can help create the appropriate environment.</p>	<p>Issue B below.</p>
<p>Mr. Grund wondered whether a requirement with exceptions would work better.</p>	<p>The Task Force notes that this was the position in the ED.</p>
<p>Mr. Baumann asked whether the project is addressing SIAs that impact the financial statements or any SIAs. Mr. Fleck noted that it is the latter, pointing out that a cartel arrangement could have not only an impact on the financial statements but also broader implications beyond the client.</p>	<p>Mr. Franchini noted that the ED focused on SIAs that could impact financial reporting and also the subject matter of which falls with the PA's expertise.</p> <p>However, the IESBA has now agreed that the scope of the proposals should not be limited to SIAs that impact the financial statements only. The IESBA noted that it made sense to limit matters to disclose to the PA's expertise when there was a requirement so as to avoid placing an undue burden on the PA to report matters outside the PA's expertise. However, in the absence of a requirement, the IESBA agreed that the PA should be free to disclose matters that are also outside the PA's expertise, provided these matters are related to the business activities of the client or employer.</p>
<p>Regarding the requirement to disclose, Mr. Baumann wondered whether the threshold should be a "likely" bar as opposed to a suspicion.</p>	<p>Point not accepted.</p> <p>The Task Force believes that at the point of considering disclosure, there should be no further test of likelihood. At that point, the PA should have ruled out matters in respect of which there are insufficient grounds for disclosure. The only consideration that would be relevant then is whether disclosure would be in the public interest, provided that such disclosure would not be contrary to law or regulation.</p>
<p>Mr. Baumann was of the view that it would be appropriate to establish two different thresholds, noting that a threshold at the level of a suspicion would be too low for disclosure.</p>	<p>Ditto.</p>
<p>Mr. Fleck noted that the threshold for disclosure in</p>	<p>Point noted.</p>

Representatives' Comments	Task Force/IESBA Response
UK law is reason to believe.	
Mr. Baumann also asked how the project would intersect with the ISAs, particularly whether there was an intention to amend both sets of standards at the same time. He was of the view that it would be important to coordinate with the IAASB on a way forward.	Point accepted. The IESBA has been coordinating, and is continuing to coordinate, with the IAASB at both staff and leadership levels regarding alignment between the proposals and the ISAs.
Mr. Diomeda emphasized the importance of thinking about the consequences when seeking to establish a requirement. He was of the view that it is always difficult to balance having a requirement and judging the effect of not applying the requirement because the consequences are not known until after the fact. He felt that with a requirement, there would be an expectation that all PAs will comply. He was of the view that one should be aware that PAs would need to consider how to react. Accordingly, it is not always right to go with a requirement.	Point accepted. The Task Force and IESBA are actively considering the practicalities of establishing a requirement for disclosure and what would be the most appropriate alternative to a requirement. See discussion under Issue E below.
<p>REQUIREMENT TO DISCLOSE A SIA TO AN EXTERNAL AUDITOR</p>	
Mr. Hansen expressed the view that this proposed requirement was one that would be applicable not so much to individual PAs as opposed to a firm. With respect to PAs providing professional services to non-audit clients, he questioned why the ED limited the disclosure of SIAs to those that relate to the subject matter of the services. He was of the view that a PA has a responsibility to act in the public interest, regardless of the service provided.	Point accepted. The IESBA has now agreed not to limit the disclosure of SIAs to those that relate to the subject matter of the PA's services.
Mr. Hansen also reiterated that NASBA is not supportive of creating a right to disclose as it is the prerogative of national legislators to establish rights. Instead, there should be an expectation to disclose.	The Task Force notes that the right to disclose was intended to be a permission granted by the Code to override the duty of confidentiality established <i>in the Code</i> . The Code cannot establish legal rights nor can it override legal or regulatory requirements.
<p>STRAW MAN</p>	
With reference to the Task Force's straw man of an alternative approach to the ED, Mr. Fleck	Mr. Franchini noted that the Code already includes a principle regarding taking action when the PA faces

Representatives' Comments	Task Force/IESBA Response
<p>asked Representatives whether they agreed that it would be reasonable to expect PAs to go through the escalation process. He was of the view that the credibility of that approach would depend on how the PA reached his or her views. Mr. Hansen wondered whether the escalation would always be possible. Mr. Diomeda was of the view that escalation may not be possible in the context of a small- and medium-sized entity (SME). Mr. Thompson noted that ISAs apply to auditors only. Accordingly, he wondered whether PAIBs would know what they should do.</p>	<p>unethical behavior.</p> <p>The Task Force notes that the straw man anticipates and deals with cases where escalation is not possible.</p>
<p>Messrs. Kuramochi and Grund noted that while they had personal views on the matter, they were unable to express an organizational view.</p>	<p>Point noted.</p>
<p>Ms. Blomme noted that it was clear that there was not overwhelming support for the ED, consistent with FEE's view. She also noted that while there had not been a prior opportunity to study the straw man, her immediate reaction was that it would be worth further exploration. Mr. Koktvedgaard and Ms. de Beer shared Ms. Blomme's views.</p>	<p>Support noted.</p>
<p>Mr. Finnell noted that while he had not had an opportunity to discuss the straw man with the IAIS, the proposed alternative approach appeared reasonable. He encouraged the Task Force to consider Mr. Baumann's comments regarding establishing separate thresholds for investigation and disclosure. Mr. Hansen agreed.</p>	<p>Support noted.</p> <p>See response to Mr. Baumann's comments above.</p>
<p>Mr. Morris highlighted the suggestion from IOSCO regarding breaking up the issues into manageable pieces. Given that IOSCO's focus is on PIE audits, he wondered what the principles should be for PIEs. He noted that ISAs 240³ and 250⁴ appear to set out appropriate courses of action to take. Mr. Hansen was of the view that the proposals should not be limited to PIE audits.</p>	<p>Point noted. The IESBA is exploring what the most appropriate disclosure standard should be for auditors of PIEs where legal protection is available. See further discussion under Issue E below.</p>

³ ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

⁴ ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*

Representatives' Comments	Task Force/IESBA Response
<p>Mr. Diomeda wondered why the project should move forward and whether it would lead to a result.</p>	<p>The IESBA considered whether or not to continue the project at its March 2013 meeting and agreed that it should continue. See the minutes of the March 2013 IESBA meeting at: http://www.ifac.org/sites/default/files/meetings/files/20130613%20-%20IESBA%20-%20Final%20Minutes%20of%20March%202013%20Meeting_0.pdf</p>
<p>Mr. Darinzo noted that all the IIA's views on the ED are included in the majority views of respondents, as summarized by Mr. Franchini. He noted that he would take the issues back to the IIA for further consideration.</p>	<p>Point noted.</p>
<p>Mr. Baumann and Ms. Lopez noted that further study would be needed as to whether the straw man was heading in the right direction.</p>	<p>Point noted.</p>
<p>Ms. Manabat noted that this is a worthwhile but challenging project. She encouraged the Task Force to further explore the straw man and would await thinking on it to have advanced before consulting internally within her organization.</p>	<p>Point noted.</p>

Matters for CAG Consideration

A. Alignment with ISA Terminology

7. When the IESBA started discussing this project in October 2009, it focused on developing guidance to support a PA in responding to a suspected fraud or illegal act that he or she has encountered. The IESBA subsequently considered the difference between a fraud and an illegal act, and agreed that a fraud is an illegal act. The IESBA therefore determined that the project should address SIAs.
8. In continuing to reflect on the straw man, the Task Force felt that it would be confusing to continue to use the term “suspected illegal act” when the definition of that term is virtually identical to the definition of “non-compliance with laws or regulations” in International Standard on Auditing (ISA) 250.⁵ Indeed, the starting point for the definition of a SIA in the exposure draft⁶ (ED) was the

⁵ ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, defines “non-compliance” as follows:
 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.

⁶ August 2012 exposure draft, *Responding to a Suspected Illegal Act*

definition of “non-compliance” in ISA 250.⁷ However, it does not appear from a review of the minutes of past IESBA discussions on this project that the Board had previously considered aligning the SIA terminology with that used in the ISAs.

9. The Task Force believes that there would be benefit in making this alignment. Apart from avoiding the potential confusion that may arise from using different terminology in the Code for a concept that is effectively defined identically in the ISAs, doing so would more appropriately capture the idea that the provisions in Sections 225⁸ and 360⁹ address matters that are broader than just the law. Further, proposed Section 225 in the straw man maps to ISA 250 to a large degree and picks up where it ends, and therefore using the same terminology would support this closer alignment.
10. The Task Force also felt that there would be a number of other advantages, including the following:
 - Aligning terminology would help respond to a number of concerns from respondents to the ED and leadership of the IAASB about the need to minimize differences with ISA 250.
 - Using the ISA terminology of “identified or suspected non-compliance with laws or regulations” throughout would help address the concern about whether the proposals are still only referring to “suspected illegal acts” at the disclosure stage. At the same time, this would eliminate the need to over-engineer the PA’s response process by calibrating the precise thresholds at which specific actions would be called for.
 - The potential for complications, and therefore significant delay in finalizing this project, would be minimized as the IESBA seeks to further its discussions with the IAASB on the revised proposals.
 - The focus on “illegal acts” may obscure the fact that any form of non-compliance with laws or regulations identified in the performance of a professional service or activity should be brought to the attention of the client or employing organization.
11. Accordingly, the Task Force proposes changes to the straw man to conform terminology to the ISAs.

Matter for CAG Consideration

1. Do Representatives agree with the Task Force’s proposal above?

B. Permission to Override the Duty of Confidentiality

12. The Task Force proposes that the Code establish in Section 140¹⁰ that a PA be permitted to override the duty of confidentiality under the Code in appropriate circumstances (see first line of paragraph 140.8 of Agenda Item F-1).¹¹ These circumstances will include those already set out in paragraph 140.7 of the extant Code. The Task Force, however, proposes that the Code indicate that overriding confidentiality to comply with ethics standards specifically includes disclosing

⁷ See minutes of the February 2011 IESBA meeting

⁸ Proposed Section 225, *Responding to a Suspected Illegal Act*

⁹ Proposed Section 360, *Responding to a Suspected Illegal Act*

¹⁰ Section 140, *Confidentiality*

¹¹ Paragraph numbers hereafter refer to the straw man presented in Agenda Item F-1 unless otherwise stated.

identified or suspected non-compliance with laws or regulations to an appropriate authority in the circumstances described in Sections 225 and 360 (see paragraph 140.10(iv)).

13. The Task Force felt it important to place this permission in the context of the vital role that confidentiality itself plays in the public interest, a point which some respondents to the ED had highlighted, i.e., that confidentiality, as a fundamental principle, serves the public interest because it facilitates the free flow of information between the PA and the PA's client or employer (see paragraph 140.7). The Task Force believes that incorporating such a statement in Section 140 sets the appropriate tone for the permission that the Code then grants for the PA to override confidentiality in the specific circumstances identified in that section.
14. The Task Force believes that the alternative of a permission to override confidentiality under the Code, supported by complementary guidance as outlined below, addresses many of the fundamental concerns that were expressed by respondents regarding the key proposals in the ED.

Matter for CAG Consideration

2. Do Representatives agree with the Task Force's proposal above?

C. Ethical Obligation to Respond to Non-Compliance with Laws or Regulations

15. At its March 2013 meeting, the IESBA generally reaffirmed its view that a PA has an ethical obligation to respond to an instance of non-compliance with laws or regulations and not turn a blind eye to it, given the potential for certain instances of non-compliance to have serious consequences for the public. Given the importance of this principle, the Task Force believes that it should be anchored within the Code's fundamental principles.
16. In this regard, the Task Force believes the most appropriate fundamental principle that would support and stimulate this behavior is professional behavior. The Task Force is of the view that willfully ignoring an instance of non-compliance would be tantamount to not living up to the public's high expectation of the profession to act in the public interest, and therefore represent conduct that would discredit the profession.
17. The Task Force therefore proposes that Section 150¹² be amended to make clear that conduct that may adversely affect the good reputation of the profession includes not responding to circumstances where the PA has identified or suspects non-compliance with laws or regulations by a client or an employer (see paragraph 150.1). The Task Force also believes that an amendment to the definition of professional behavior in Section 100¹³ would be necessary to make clear that the fundamental principle is about avoiding in the broadest sense conduct, as opposed to mere action, that discredits the profession (see paragraph 100.5).

Matter for CAG Consideration

3. Do Representatives agree with the Task Force's proposals above?

¹² Section 150, *Professional Behavior*

¹³ Section 100, *Introduction and Fundamental Principles*

D. Alternative Approach to Proposed Section 225 – PAs in Public Practice

18. In the light of respondents' comments on the ED, the Task Force has reconsidered Section 225 and proposes the revised approach outlined below.
19. On exposure, there was greater opposition to, than support for, establishing a distinction in the ED between PAs providing professional services to audit clients and PAs providing non-audit services (NAS) to non-audit clients, mainly because many did not believe the obligation to address an instance of non-compliance and the steps to be taken should depend on the nature of the professional services provided. Accordingly, the Task Force proposes that Section 225 no longer make that distinction. Instead, the Task Force proposes that Section 225:
 - (a) Establish the responsibilities that should apply to both categories of PAs; and
 - (b) Only provide specific guidance where a distinction truly needs to be made (for example, see paragraphs 225.14-16).
20. With respect to PAs providing NAS to non-audit clients, the Task Force also proposes that Section 225 not deal separately with clients that are entities and those that are individuals, as it will be clear when the guidance applies only to entities, e.g., when it is referring to management or those charged with governance (TCWG).
21. In moving away from a requirement to disclose certain instances of non-compliance to an appropriate authority, and taking into account input received from Committee 1 of the International Organization of Securities Commissions (IOSCO), the Task Force has focused on developing guidance for Section 225 that would assist the PA in dealing with the difficult, and often stressful, situation that arises when the PA encounters non-compliance. Broadly, the Task Force has structured the guidance as follows:
 - (a) Recognizing *a priori* that the responsibility for complying with laws and regulations rests first and foremost with the client or its management and TCWG. This responsibility includes addressing any non-compliance by the client or by TCWG, management or employees of the client (see paragraph 225.2). The Task Force believes that articulating this fact would be responsive to the many respondents to the ED who argued that addressing non-compliance should be the overriding duty of management, including consideration of whether the matter may need disclosure to an appropriate authority. This is also broadly consistent with the approach taken in ISA 250;
 - (b) As in the ED, making it clear that when the PA encounters non-compliance, the PA's first responsibility should be to comply with any laws or regulations that govern how non-compliance should be addressed (see paragraph 225.3);
 - (c) Laying out the appropriate requirements and guidance regarding:
 - (i) Obtaining an understanding of the matter (paragraphs 225.4-12);
 - (ii) Evaluating the response of the client (paragraphs 225.13-17); and
 - (iii) Disclosing non-compliance to an appropriate authority (paragraphs 225.18-24); and
 - (d) Dealing with documentation.

Obtaining an Understanding of the Matter

22. The Task Force proposes that Section 225 move away from what many respondents perceived to be an overly prescriptive approach in the ED to one that is couched more in terms of how the Code may help the PA deal with the situation. Accordingly, in the Obtaining an Understanding phase, rather than focusing on confirming or dispelling a suspicion, the straw man articulates the PA's responsibilities and options in terms of:
- Seeking to obtain an understanding of the nature of the matter and the circumstances in which it arose, consistent with ISA 250 (paragraph 225.4);
 - Explaining why choosing to consult with others within the firm, a network firm, a relevant professional body or legal counsel as part of seeking an understanding of the matter may be beneficial (paragraph 225.6);
 - Explaining why a PA performing a NAS for an audit client of the firm or network firm should discuss the matter with the engagement partner for the audit (paragraph 225.7);
 - Explaining why the PA should communicate with the client regarding the matter (paragraph 225.8);
 - Assessing whether the client or its management or TCWG understand their legal or regulatory responsibilities with respect to the matter and, if not, considering recommending that they obtain legal advice (paragraph 225.11); and
 - Explaining what courses of action are available where:
 - The PA suspects that management or TCWG are involved in the non-compliance (paragraph 225.10); or
 - Insufficient information is obtained to satisfy the professional accountant that the client is in compliance with laws and regulations (paragraph 225.12).

Evaluating the Response of the Client

23. The Task Force does not believe that the PA's responsibility should end at the point of communicating the matter with the client or its management or TCWG given that certain instances of non-compliance may materially impact the entity's operations and its financial statements, and may have serious consequences for the public. Accordingly, the Task Force proposes that an explicit requirement be established for the PA to evaluate whether the client, its management or TCWG have appropriately addressed the matter (paragraph 225.13).
24. The Task Force then proposes guidance to:
- Assist the PA in making such an evaluation (paragraphs 225.13); and
 - Lay out possible courses of action if the PA judges that the response of the client is not appropriate or the PA is unable to assess whether the response is appropriate (paragraphs 225.15-16).
25. If all other courses of action have been pursued and the PA believes that the client still has not appropriately addressed the matter, or if the PA is unable to assess whether the response is appropriate, the Task Force proposes that the PA be then required to make a determination as to whether to disclose the matter to an appropriate authority (see paragraph 225.17).

Disclosing Non-Compliance to an Appropriate Authority

26. With disclosure to an appropriate authority now being only an option as opposed to a requirement, the Task Force felt it important to link voluntary disclosure to the distinguishing mark of the profession in terms of the profession's acceptance of its responsibility to act in the public interest. Therefore, overriding the duty of confidentiality established by the Code in these circumstances would only be appropriate where the PA judges that disclosure would be in the public interest (see paragraph 225.18).
27. The Task Force proposes enhanced guidance, including relevant factors to consider, to assist the PA in determining whether or not to disclose the matter to an appropriate authority (see paragraphs 225.19-20).
28. Given that the PA now has full discretion in choosing whether or not to disclose an instance of non-compliance to an appropriate authority, the Task Force did not believe it would be necessary to retain the exception provision in the ED, i.e., circumstances where a reasonable and informed third party would conclude that the consequences of disclosure are so severe as to justify not complying with the requirement to disclose. Accordingly, that provision has been deleted.
29. One of the matters that IOSCO had raised in its comment letter is that a consideration of disclosure of non-compliance with laws or regulations to an appropriate authority should have regard to the capacity of that body to intake, process and address reports of such non-compliance. The Task Force did not believe that PAs in all cases will have the means or ability to make such an assessment. Also, with the proposal to replace the requirement to disclose with the concept of discretion, the Task Force believes this particular consideration becomes less relevant. Accordingly, the Task Force proposes that this suggestion not be identified as a specific factor to consider.
30. Equally, the Task Force believes that with the discretion to disclose, it no longer becomes an impediment to compliance with the Code if there is no appropriate authority in the relevant jurisdiction to whom to disclose the instance of non-compliance, and therefore this matter is of less concern.

Matters for CAG Consideration

4. Do Representatives agree with the Task Force's proposals above? In particular, are the nature and extent of the proposed enhanced guidance appropriate?

E. Disclosure in the Case of an Audit of a PIE

31. At the June 2013 meeting, the IESBA explored whether to include a specific provision in Section 225 to deal with disclosure of an instance of non-compliance to an appropriate authority in the case of an audit of a PIE where the legal framework affords protection for disclosure. The Task Force tentatively floated two options with respect to disclosure in this situation, i.e., an expectation and a requirement, subject to the following further conditions:
 - (a) The matter is material to the financial statements;
 - (b) There is an appropriate authority to receive the information; and
 - (c) The client has not already adequately disclosed the matter to an appropriate authority.

32. The Task Force has further reflected on these options in the light of comments from the IESBA. The Task Force firstly considered the option of requiring disclosure in particular circumstances. The Task Force felt that establishing an outright requirement, even in the limited circumstances circumscribed by the above conditions, would run up against several of the same fundamental concerns respondents had raised on the ED. Chief among those is the argument that a disclosure requirement is a matter that can only be properly addressed by legislators or regulators at the national level as only they, and not the Code, will be able to operationalize such a requirement in the context of the specific legal and regulatory frameworks of their jurisdictions. In addition, an outright requirement would raise the issue of how PAs should resolve the potentially complex interactions between a requirement in the Code and national laws and regulations.
33. The Task Force also felt that the option of an expectation, coupled with the permission to override confidentiality, could give rise to the same question that was raised by a number of respondents to the ED as to whether this would mean a de facto requirement to disclose. In particular, an expectation might be thought to create a moral obligation on the PA, such that if the PA does not disclose the PA would be falling short of the standard of professional conduct expected by the Code. To this extent, the PA might even be thought to be in breach of the Code.
34. Given the above and the remit from the Board to evaluate the possibilities, the Task Force's preferred option would be to ask the IESBA at its September 2013 meeting to consider the merits of establishing a *presumption* (which can be rebutted) that disclosure will be made in certain specific circumstances. A presumption would provide the PA with the ability to determine not to disclose if non-disclosure can be justified in the circumstances. The Task Force notes that the concept of a rebuttable presumption is already established in the professional literature – specifically, ISA 240 requires auditors to evaluate certain matters based on a presumption that there are risks of fraud in revenue recognition but allows for the auditor to conclude that the presumption is not applicable in the particular circumstances of the engagement.¹⁴
35. For the alternative of a presumption to set a robust standard, the Task Force believes it would be necessary for the presumption to be accompanied by a documentation requirement should the PA identify valid reasons not to make disclosure in the circumstances. The Task Force has proposed relevant text in paragraphs 225.22 and 225.26 in the straw man to illustrate how this notion would be articulated. In addition, for there to be proper conditions for the presumption to exist, the Task Force believes a tightening of the legal protection condition would be necessary – specifically that the PA should be satisfied that the legislation or regulation that is providing the protection is sufficiently established to protect the PA from civil or criminal liability (see paragraph 225.22(d)).
36. The Task Force also discussed the need to include materiality as one of the preconditions. As the presumption that disclosure will be made would follow from the PA's evaluation of the gravity of the matter to determine whether disclosure would be in the public interest, the Task Force felt that materiality may appear to be an unnecessary condition. The Task Force, however, recognizes that materiality is a well-established concept in an audit of financial statements and is well understood by auditors. On balance, therefore, the Task Force proposes that this precondition be retained to assist PAs in judging when they would face situations in which there could be a presumption of disclosure (see paragraph 225.22(a)).

¹⁴ ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraph 26

Matters for CAG Consideration

5. Do Representatives support including a specific provision in Section 225 to establish an appropriate disclosure standard in the case of an audit of a PIE?
6. If so, do Representatives agree that the Task Force's preference of a presumption as described above would be the most appropriate option?

F. Proposed Section 360 – PAIBs

37. The Task Force has generally conformed Section 360 to the changes proposed in Section 225.

Matter for CAG Consideration

7. Representatives are asked for any comments on the revised Section 360 in the straw man.

Material Presented – CAG Paper

Agenda Item F-1 Responding to Non-Compliance with Laws or Regulations—Straw Man

Material Presented – IESBA CAG REFERENCE PAPERS

SIA ED <http://www.ifac.org/sites/default/files/meetings/files/Agenda%20Item%202-B%20-%20Suspected%20Illegal%20Acts%20ED.pdf>

ISA 250 <http://www.ifac.org/sites/default/files/meetings/files/Agenda%20Item%202-C%20-%20ISA%20250.pdf>

Project History

Project: Responding to a Suspected Illegal Act

Summary

	CAG Meeting	IESBA Meeting
Project Commencement	March 2010 September 2010	October 2009 November 2010
Development of Proposed International Pronouncement (up to Exposure)	March 2011 September 2011 March 2012	February 2011 June 2011 October 2011 February 2012 April 2012 June 2012
Exposure	August 2012 – December 2012	
Consideration of Respondents' Comments on Exposure	April 2013	March 2013 June 2013

CAG Discussions: Detailed References

Project Commencement	<p><u>March 2010</u></p> <p>See IESBA CAG meeting material: http://www.ifac.org/sites/default/files/meetings/files/5271.pdf</p> <p>See CAG meeting minutes (section C of the following material): http://www.ifac.org/sites/default/files/meetings/files/5699_0.pdf</p> <p><u>September 2010</u></p> <p>See IESBA CAG meeting material: http://www.ifac.org/sites/default/files/meetings/files/5676_0.pdf</p> <p>See CAG meeting minutes (section C of the following material): http://www.ifac.org/sites/default/files/meetings/files/6002_0.pdf</p>
Development of Proposed International	<p><u>March 2011</u></p> <p>See IESBA CAG meeting material:</p>

<p>Pronouncement (Up to Exposure)</p>	<p>http://www.ifac.org/sites/default/files/meetings/files/6011_0.pdf</p> <p>See CAG meeting minutes (section D of the following material):</p> <p>http://www.ifac.org/sites/default/files/meetings/files/20110815-IESBA%20CAG%20-Agenda%20Item%20A-1%20-%20Draft%20CAG%20Minutes%20-%20New%20York%20March%202011.pdf</p> <p><u>September 2011</u></p> <p>See IESBA CAG meeting material:</p> <p>http://www.ifac.org/sites/default/files/meetings/files/20110831-IESBA%20CAG%20-%20Agenda%20Item%20C%20-%20Responding%20to%20a%20Suspected%20Illegal%20Act.pdf</p> <p>See CAG meeting minutes (section C of the following material):</p> <p>http://www.ifac.org/sites/default/files/meetings/files/20120217-IESBA%20CAG-%20Agenda%20Paper%20A-1%20-%20Draft%20IESBA%20CAG%20Sept%202011%20Minutes_0.pdf</p> <p><u>March 2012</u></p> <p>See IESBA CAG meeting material:</p> <p>http://www.ifac.org/sites/default/files/meetings/files/20120227-IESBA%20CAG%20-%20Agenda%20Paper%20D%20-%20Responding%20to%20a%20Suspected%20Illegal%20Act.pdf</p> <p>See CAG meeting minutes (section D of the following material):</p> <p>http://www.ifac.org/sites/default/files/meetings/files/Agenda%20Paper%20A-1%20-%20Draft%20CAG%20Minutes.pdf</p>
<p>Consideration of Respondents' Comments</p>	<p><u>April 2013</u></p> <p>See IESBA CAG meeting material:</p> <p>http://www.ifac.org/sites/default/files/meetings/files/Agenda%20Item%20B%20-%20Suspected%20Illegal%20Acts%20-%20Cover%20Note.pdf</p> <p>See draft April 2013 CAG meeting minutes at Agenda Item A (section B).</p> <p>See report back on April 2013 meeting in paragraph 6 of this CAG paper.</p>