

**Meeting:** IESBA CAG  
**Meeting Location:** New York  
**Meeting Date:** September 9-10, 2014

## Agenda Item

# E

### **Responding to Non-Compliance with Laws and Regulations (NOCLAR)— 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 March 2014 CAG Meeting.
2. To obtain CAG Representatives' views on a proposed way forward on the project in the light of the feedback from the NOCLAR roundtables.

#### **Project Status and Timeline**

3. At its March 2013 meeting, the IESBA considered the significant comments received on the Exposure Draft (ED), *Responding to a Suspected Illegal Act*, and an outline of an alternative to the approach set out in the ED regarding a professional accountant's (PA) responsibilities regarding suspected NOCLAR.
4. At its December 2013 meeting, the IESBA agreed to hold a series of three global roundtables in 2014 (Hong Kong, May 20; Brussels, June 13; and Washington DC, July 10) to seek further stakeholder input on tentative revised proposals.
5. At its October 2014 meeting, the IESBA will consider the significant feedback provided by the roundtable participants, the Task Force's related analysis and proposals, and CAG Representatives' input from this CAG meeting. Agenda Item E-1 summarizes the roundtable feedback. Agenda Item E-2 (the Briefing Note distributed to the roundtable participants) provides background information, including the revised proposals the IESBA tentatively agreed in December 2013. Agenda Item E-3 provides an overview of a tentative revised framework developed by the Task Force in the light of the roundtable feedback.
6. Subject to the outcome of its October 2014 deliberations, the IESBA will consider a revised draft of the proposals with a view to approving a re-ED at its January 2015 meeting.
7. The Appendix to this paper provides a project history, including links to the relevant CAG documentation.

**March 2014 CAG Discussion**

8. Below are extracts from the draft minutes of the March 2014 CAG meeting,<sup>1</sup> and an indication of how the project Task Force or IESBA has responded to CAG Representatives' comments.

Matters Raised	Task Force/IESBA Response
DISCLOSURE OF SUSPECTED NOCLAR TO AN APPROPRIATE AUTHORITY	
<p>As a general comment, Mr. Fukushima wondered whether the current Task Force proposal not to move forward with a rebuttable presumption of disclosure of suspected NOCLAR to an appropriate authority was consistent with the message in the proposed IESBA Strategy and Work Plan, 2014-2018 (SWP) regarding the Board's commitment to maintain the Code as a leading set of global ethical standards. He suggested that the Board consider the direction of the project in the context of the SWP.</p> <p>More specifically, Mr. Fukushima commented that not reporting suspected NOCLAR to an appropriate authority when the matter has a significant impact on the financial statements might cause the professional accountant (PA) to be in breach of the fundamental principle of integrity. In this regard, he noted that paragraph 110.2 of the Code requires the PA not to knowingly be associated with reports or other information where the PA believes such information contains a materially false or misleading statement. He also noted that the International Auditing and Assurance Standards Board (IAASB) is currently proposing under its ISA 720<sup>2</sup> project that the auditor highlight in the auditor's report misstatements of fact or material inconsistencies in other information in documents containing audited financial statements. He wondered whether the IESBA and IAASB were taking different directions in addressing such matters and encouraged both boards to liaise with</p>	<p>Ms. Gardner emphasized that the IESBA is seeking to raise the bar in terms of how best the PA can serve the public interest when facing NOCLAR, noting that the balance between the public interest and the fundamental principle of confidentiality is a fine one to strike. She conveyed that the Board has already endeavored to conform the proposals to ISA 250<sup>3</sup> and paragraph 110.2 of the Code. She added that the challenge for the Board is that it is seeking to go beyond the financial statements and also to cover acts of non-compliance that may have significant long-term consequences, not necessarily those limited to the scope of ISA 250 and Section 110 of the Code. So the Board was aiming to make clear in the proposals that the PA must first comply with any applicable laws and regulations when facing suspected NOCLAR. However, where there are no legal or regulatory requirements, the proposals would still require the PA to go through the process of considering the public interest and whether there is a need to disclose the matter to an appropriate authority.</p>

<sup>1</sup> The draft minutes will be approved at the September 2014 IESBA CAG meeting.

<sup>2</sup> International Standard on Auditing (ISA) 720, *The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements*

<sup>3</sup> ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*

Matters Raised	Task Force/IESBA Response
each other.	
<p>Mr. James noted that when IOSCO members consider the public interest and determine that there is something to report in that context, they would find a way to communicate it. He was of the view that the concept of a rebuttable presumption took away the notion that the PA would report a suspected NOCLAR if deemed appropriate to do so. He felt that paragraph 225.20<sup>4</sup> provided the PA with a basis for deciding not to make such a disclosure, a situation IOSCO members would not feel would be right. He was of the view that the pendulum had swung too far the other way and that further work was needed to bring it back.</p>	<p>Ms. Gardner noted that the Board had made the consideration of disclosure a requirement. In addition, paragraph 225.21 provided additional considerations to assist the PA in determining whether to disclose the matter to an appropriate authority. With respect to the rebuttable presumption, she indicated that the Board believed that this would go too far, especially in the context of emerging countries. She added, however, that the Task Force would revisit the wording of paragraph 225.20 with the aim of encouraging disclosure.</p>
<p>In relation to the proposed explanation regarding how the PA would judge the gravity of the matter, Mr. James noted that some IOSCO members were concerned that the phrase “wider damage to the public” would set too high a bar for disclosure. As an example, he noted that insider trading would generally not have a wide impact on the public and may therefore not be captured under the provisions. Ms. Gardner noted that the Task Force had been endeavoring to identify appropriate examples of reportable NOCLAR since the December 2013 IESBA meeting as these could assist in clarifying why the public interest would be better served in disclosure. She added that the Task Force would consider the matter further.</p>	<p>Mixed views emerged from the roundtables regarding the types of NOCLAR that should be reportable. Some agreed that insider trading should be reportable although it would be difficult to establish credible evidence for it. Others were of the view that the standard should focus on a “hard core” of issues or criminal acts. Some participants also perceived examples to be limiting and suggested that they might be better provided outside the Code. The Task Force will be further considering the issue of thresholds in the light of the roundtable input.</p>
<p>Ms. Lang agreed that providing examples of the types of reportable NOCLAR would be helpful. She felt that the generic example provided in the proposed standard was self-evident. She was of the view that the provisions would be more understandable if additional examples were provided, adding that in her view most people would concur with Mr. James’s example.</p>	<p>See response to Mr. James’s comment above.</p>

<sup>4</sup> Proposed Section 225, *Responding to Non-Compliance with Laws and Regulations*

Matters Raised	Task Force/IESBA Response
<p>Mr. Dalkin was of the view that it is important to consider the burden on the auditor of disclosing suspected NOCLAR to an appropriate authority above and beyond the auditor’s responsibilities with respect to the financial statements. Ms. Gardner explained that what the Task Force had been endeavoring to scope in were matters not focused only on the financial statements. She noted, however, that the Task Force would consider the feedback further.</p>	<p>Point noted, The Task Force is reconsidering the issue of scope given the feedback from the roundtables.</p>
<p>Ms. Blomme expressed a concern about the broad requirement for PAs, adding that PAs in the EU will already be subject to a requirement to report a material breach of laws and regulations to an appropriate authority in the context of the statutory audit of public interest entities (PIEs). Ms. de Beer noted that the EU requirement does not involve a search for NOCLAR but more a “stumbling across” the matter. She wondered what the materiality frame of reference would be if the scope was broader than the financial statements. She noted that in South Africa, auditors have a legal duty to report irregularities to the Independent Regulatory Board for Auditors.</p>	<p>Points noted. The Task Force is reconsidering both the issue of scope and the issue of thresholds given the feedback from the roundtables.</p>
<p>Mr. Bhave commented that paragraph 225.21 provides no indication of what is in the wider public interest. He wondered whether there should be a reference to the public interest somewhere. In addition, he wondered whether a code of ethics should make reference to compliance with laws and regulations, as this should be taken for granted. Ms. Gardner noted that a reference to the public interest is already made in paragraph 225.20, with the provisions then taking the PA through the process of determining whether to report the matter to an appropriate authority.</p>	<p>Point noted. One of the key messages from the roundtables is that the consideration of action by the PA must first start with what law or regulation requires and that in the vast majority of cases, complying with applicable laws and regulation would enable the PA to appropriately respond to the matter in the public interest.</p>
<p>Mr. James expressed a concern about broadening the scope beyond financial statements as thousands of laws and regulations could then become relevant. He also agreed with Ms. de Beer that the PA should not be seeking out</p>	<p>Points noted. The Task Force is reconsidering both the issue of scope and the issue of thresholds given the feedback from the roundtables. The Task Force also agreed, and there was broad consensus at the roundtables, that the PA should not have a</p>

Matters Raised	Task Force/IESBA Response
NOCLAR. In relation to the public interest filter, he wondered where that should come in. He indicated that IOSCO felt that this should come more at the back end in the context of enforcement. He questioned whether PAs would understand the concept of the public interest and how to apply it.	responsibility to search for NOCLAR.
Mr. Dalkin was of the view that there may be circumstances that go beyond a “stumbling over.” Acknowledging that he was not knowledgeable about all laws and regulations, he wondered whether auditors were being assigned responsibility beyond their expertise. Ms. Gardner highlighted that the proposals already recognized this dimension as paragraph 225.7 notes that the closer the matter is to the PA’s expertise, the greater the duty for the PA to pursue the matter with the client.	Point noted, Given the feedback from the roundtables, the Task Force is reconsidering whether the scope of the proposals should be more closely linked to the PA’s expertise.
Ms. Lang felt that paragraph 225.7 needed clarification. Ms. Gardner explained that the intention was to introduce a filter linked to the PA’s expertise.	Point noted. The Task Force will revisit the wording of the guidance when reconsidering the scope issue.
<b>COMMUNICATION BETWEEN EXISTING AND PROPOSED AUDITOR</b>	
At Mr. Koktvedgaard’s invitation Ms. Blomme outlined the EU requirement regarding communication between an existing auditor and a proposed one. Mr. Thompson noted that no client consent would be needed and that the communication would cover not all the proposed auditors but only the chosen one.	Points noted.
Mr. Hansen commented that the existing auditor could simply refuse to communicate with the proposed auditor and resign.	Ms. Gardner noted that simply resigning would not be acceptable. Rather, what the Board is proposing is to require the communication between the two firms.
Mr. Koktvedgaard commented that what the proposals achieved in effect was to lead the proposed auditor not to accept the appointment if the information from the existing auditor was not	Points noted. The Task Force will reconsider the proposal, also taking into account input received on this issue at the roundtables.

Matters Raised	Task Force/IESBA Response
<p>forthcoming. Mr. Hansen noted that the proposals only required the proposed auditor to carefully consider a failure or refusal by the client to grant consent to the existing auditor to communicate with the proposed auditor, not to decline to accept the appointment. Ms. Gardner noted that such information would be strong warning to the proposed auditor to consider whether to proceed with accepting the appointment.</p>	
<p>Mr. James acknowledged the Board’s efforts in trying to strengthen the Code with the objective of achieving a high quality Code. He felt that if the intention was to strengthen the Code, then the aim should be to benchmark against the highest standards around, which would then enable the Board to identify where the gaps are and how they can best be closed. He was of the view that this would be more of a mindset.</p>	<p>Ms. Gardner noted that the Board was endeavoring to establish a high benchmark that is at the same time practicable and as widely applicable as possible.</p>
<p>Mr. Dalkin was of the view that the proposed communication requirement between the existing auditor and the proposed auditor appeared to be a reasonable one.</p>	<p>Support noted.</p>
DOCUMENTATION	
<p>Mr. Koktvedgaard wondered whether consideration had been given to the possibility of no documentation being prepared.</p>	<p>Ms. Gardner noted that the Board had tried to focus more on the benefits of documentation. Mr. Siong noted that auditors already have a documentation requirement under the ISAs.</p>
<p>Mr. James suggested clarifying where the documentation requirement is located, as it was unclear who has the responsibility to document – all PAs or only auditors. He also felt that it was unclear what matters PAs would be required to document. In addition, he was of the view that if the PA had stumbled across a suspected NOCLAR, the expectation would be that the PA would document the PA’s thought process for dealing with the matter.</p>	<p>Ms. Gardner noted that the documentation provisions cover all PAs but that the TF would further consider the feedback.</p>
<p>Ms. Blomme wondered whether the guidance on</p>	<p>Ms. Gardner noted that the Task Force did consider</p>

Matters Raised	Task Force/IESBA Response
documentation is consistent with the ISAs. She suggested that the Task Force cross-check it with the ISAs for consistency.	the approach in the ISAs but that it will review the proposed guidance in light of the feedback.
In relation to paragraphs 225.19 and 23, Mr. James noted that the reference is to NOCLAR but it should also be to suspected NOCLAR.	Point noted for further Task Force consideration.
OTHER COMMENTS	
Mr. Dalkin urged the Board not to increase the public expectations gap regarding the role of auditors as this could lead to diminished public trust in the profession. He felt it important that the Board consider any potential unintended consequences in exploring what the responsibilities of the profession should be regarding NOCLAR.	Point noted. The Board recognizes the need to promulgate a standard that will be enable PAs to meet their responsibility to act in the public interest but that will at the same time be practicable and operable on a global basis.
In relation to paragraph 225.17 regarding reporting to the external auditor, Ms. Lang felt that this should only come after the PA has obtained legal advice and communicated with those charged with governance (TCWG). She also perceived a mismatch between this provision and the corresponding one in the proposed Section 360 <sup>5</sup> as PAs in business (PAIBs) may not have access to the external auditor. Ms. Gardner acknowledged the concern, noting that the Task Force would further consider the feedback.	Point noted. The Task Force will reconsider the guidance in the light of the input received at the roundtables.

**NOCLAR – A Proposed Revised Framework**

9. The following sections outline a tentative revised framework to help guide PAs in responding to suspected NOCLAR when they come across such a matter while rendering a professional service to a client or carrying out their employment duties. At this stage, the Task Force is only seeking directional input from the CAG on the general approach and principles. The Task Force will meet after the CAG meeting to consider any drafting changes that may be needed to the December 2013 Board proposals.

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<sup>5</sup> Proposed Section 360, *Responding to Non-Compliance with Laws and Regulations*

A. OBJECTIVES OF THE PROPOSED SECTIONS 225 AND 360

10. In exploring a way forward in the light of the roundtable input, the Task Force has reflected on what, at the level of basic principles, the two proposed Sections should set out to achieve. First, it is to ensure that PAs do not turn a blind eye to suspected NOCLAR and that they do not, through their actions or lack thereof, bring the profession into disrepute. Phrased in terms of the fundamental principles, this objective therefore is:
  - To enable PAs to comply with the fundamental principles of integrity and professional behavior:
    - Integrity – to be straightforward and honest in all professional and business relationships.
    - Professional behavior – to comply with relevant laws and regulations and avoid any action that discredits the profession.
11. Secondly, it is to seek to avert the commission of NOCLARs that might have potential adverse consequences for stakeholders.
12. And thirdly, it is to help management to do the right thing if NOCLARs have occurred, i.e., to assist them to rectify, remediate or mitigate the consequences of NOCLARs where they do occur.
13. The Task Force believes that fulfilling those objectives will enable PAs to meet their overriding responsibility to act in the public interest. It also believes that setting out those objectives clearly at the beginning of the two Sections will set the appropriate tone and context for what then follows in the rest of the Sections. In contrast, the current proposals do not establish any clear objectives upfront but merely specify what the proposed Sections address.
14. Identifying such objectives would be consistent with advice the Board received at the May 2014 IESBA-NSS meeting about making clear upfront what is expected of PAs when they encounter suspected NOCLARs, i.e.:
  - Fundamentally, PAs should not bring the profession into disrepute.
  - Fundamentally also, the aim should be to bring about a change in behavior, not only with respect to PAs but also with respect to those with whom they interact.

**Matter for CAG Consideration**

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

B. SCOPE OF THE PROPOSALS

15. Significant concerns were expressed at the roundtables regarding the wide scope of the current proposals, notwithstanding that this is only in the context of a permission – and not a requirement – to override confidentiality under the Code to report suspected NOCLAR to an appropriate authority. The Task Force has therefore reconsidered what should reasonably be expected of PAs regarding the types of NOCLAR they should be concerned with, having regard to what should be within the scope of their professional training and expertise.
16. For auditors, ISA 250 already establishes the scope of those laws and regulations that they should consider in their audit of the financial statements, i.e.:

- (a) The provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements (e.g., tax and pension laws and regulations); and
  - (b) Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business, to an entity's ability to continue its business, or to avoid material penalties (e.g., compliance with the terms of an operating license, compliance with regulatory solvency requirements, or compliance with environmental regulations).
17. The Task Force believes that those two categories of laws and regulations fall within the expertise of auditors and therefore establish appropriate boundaries for their responsibilities under the Code. The Task Force further believes that those same categories of laws and regulations should also establish an appropriate scope for all other categories of PA. This is because regardless of these other PAs' roles and levels of seniority, it would be reasonable to expect them, by virtue of their professional training and expertise, and their knowledge of and experience with the entity (either through the provision of non-audit services to the entity or through an employment relationship), to recognize possible non-compliance with laws and regulations in those two categories.
18. The Task Force believes that for all other laws and regulations, PAs would be subject to the same ethical expectations as ordinary good citizens in responding to suspected NOCLAR. Those other laws and regulations would therefore be outside the scope of the proposed Sections.
19. The Task Force contrasted this approach to that taken under the original ED, which categorized the types of NOCLAR to be disclosed in the following three groups, i.e.:
  - For a PA in public practice providing services to an audit client:
    - NOCLARs that directly or indirectly affect the client's financial reporting; and
    - NOCLARs the subject matter of which falls within the PA's expertise.
  - For a PA in public practice providing services to a non-audit client:
    - NOCLARs that relate to the subject matter of the professional services being provided by the PA.
  - For a PAIB:
    - NOCLARs that directly or indirectly affect the employing organization's financial reporting; and
    - NOCLARs the subject matter of which falls within the PA's expertise.
20. The ED's attempt at establishing a practicable scope for the proposals was met with mixed views from respondents. While many were supportive of the proposals, others disagreed on the grounds that any restriction to the scope would be inconsistent with the public interest argument used to justify a requirement or right to disclose, or would be inappropriate in a code dealing with "ethics." Many others recorded their disagreement on the grounds that they did not support a disclosure requirement for these PAs except if it were in law or regulation.
21. Having heard the feedback from the roundtables, and particularly concerns about making sure that the provisions are practicable and operable on a global basis, the Task Force believes that aligning

the scope of the proposals with that of ISA 250 would be a sensible way forward for the reasons set out above.

22. The Task Force also considered whether there should be a carve-out of the proposals depending on whether or not the entity is a PIE. The Task Force believes that issues of NOCLAR can arise just as well in entities that are not PIEs as in those that are. Accordingly, the Task Force does not believe that non-PIEs should be scoped out.

#### **Matter for CAG Consideration**

2. Do Representatives agree with the Task Force's proposals regarding the scope of the provisions? If not, what should the scope be and why?

#### **C. FRAMEWORK FOR RESPONDING TO SUSPECTED NOCLAR**

23. As noted in Agenda Item E-1, one of the key insights from the roundtables is that the basic ethical principles should be the same for all PAs, i.e., they should respond to the issue and not turn a blind eye. However, their implementation of those principles will differ depending on their varying roles and spheres of influence. The following subsections set out the Task Force's analysis and proposals for the following categories of PA:

- Auditors
- Senior PAIBs
- PAs in public practice other than auditors
- Other PAIBs

#### **Auditors**

24. Taking into account the feedback from the roundtables, the Task Force believes that auditors should have a greater responsibility to take action to respond to suspected NOCLAR than other PAs in public practice, given the nature of the auditor's remit and the higher public expectations of them. Accordingly, the Task Force proposes that auditors be required to take the actions set out below, recognizing that more will be expected of them from an ethical perspective than under the ISAs.
25. First, auditors must raise the matter with management and, where appropriate, TCWG if it is other than clearly inconsequential. ISA 250 requires the auditor to communicate with TCWG matters involving NOCLAR that come to the auditor's attention during the course of the audit, other than when these are clearly inconsequential.<sup>6</sup> Therefore, there would be no incremental effort required in this regard under the Code.
26. As under ISA 250, such discussion would enable auditors to clarify their understanding of the matter with management and, where appropriate, TCWG, and substantiate or dispel the auditors' concerns. However, where it would be important to go beyond ISA 250 in the context of this dialogue is for auditors to stimulate or otherwise encourage management and TCWG to do the right thing, namely to:

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<sup>6</sup> ISA 250, paragraph 22

- On a best efforts basis, stop the NOCLAR if there is credible evidence that it is being planned or about to occur;
  - On a best efforts basis, rectify, remediate or mitigate the consequences of the NOCLAR for stakeholders if it has already happened; and
  - Report the matter to an appropriate authority if required by law or regulation, or if considered appropriate.
27. The Task Force believes this approach would be an improvement over the current proposals in two respects:
- Making clear that substantiation of the facts must take place early in the process, whereas under the current proposals the focus is more on evaluating whether the matter has been adequately investigated by management and, at the point of considering whether to disclose the matter to an appropriate authority, making an assessment of the degree to which the relevant information is known and substantiated.
  - Placing the emphasis on management doing the right thing rather than, under the current proposals, understanding what actions management or TCWG plan to take to address the matter.
28. At the same time, auditors must fulfill their professional responsibilities. These will include:
- Communicating the matter with TCWG, as already required under ISA 250.
  - Complying with any applicable laws and regulations, which may include reporting the matter to an appropriate authority.
  - Considering the implications for the auditor's report.
29. In the vast majority of cases in practice, management and, where appropriate, TCWG will indeed do the right thing upon being informed of suspected NOCLARs by auditors.
30. In a minority of cases, however, raising the matter with management and TCWG may not be sufficient if they do not appropriately address the issue. In those cases, auditors must determine if further action would be necessary to enable them to achieve the objectives of the provisions and to serve the public interest. The nature and extent of such further action will depend on a variety of factors, including:
- The response of management and TCWG to the matter. For example, there will be a greater expectation of auditors taking further action if management and TCWG have not disputed the facts but yet they have chosen not to do the right thing.
  - Whether TCWG are involved in the suspected NOCLAR.
  - Whether or not the entity is a PIE/listed entity.
  - The likely consequences to those potentially affected, both financial and non-financial, including nature and extent of damage to wider public.
  - The urgency of the matter.
  - The likelihood of continuing consequences.

31. The Task Force believes there are a number of possible “pressure release valves” in these circumstances. These include:
  - Informing the parent entity in the case of a component within a group.
  - Reporting the matter to an appropriate authority.
  - Terminating the engagement and resigning from the client relationship.
32. The Task Force believes that disclosure to an appropriate authority is one but not the only possible response for auditors in these circumstances. This is because whether disclosure will be practicable will depend on there being the right legal and regulatory framework to support it. The Task Force does not believe that it is feasible for the Code to specify all the conditions that must be in place for it to require auditors to report suspected NOCLAR to an appropriate authority. This is because it would be necessary to first answer fundamental questions such as what legal protection means and what it would cover, what the hallmarks of a robust and trusted legal due process would be, what the characteristics of an appropriate authority should be and whether it would be able to take action pursuant to the report, and whether there should be protection for the accused. These are ultimately matters that only legislators and regulators can establish in their particular national circumstances.
33. Accordingly, the Task Force believes that the options available for further action must depend on, and start with, consideration of the legal and regulatory framework.
34. If auditors were to determine that disclosure to an appropriate authority is the right course of action in the circumstances, assuming they were not otherwise required to do so by law or regulation, it will be necessary for the Code to provide a permission for them to override confidentiality. In this regard, the Task Force proposes that this permission be specifically provided for in Section 140<sup>7</sup> of the Code.

*Threshold for Disclosure to an Appropriate Authority*

35. The Task Force has taken note of concerns expressed at the roundtables regarding the lack of clarity in the December 2013 Board proposals concerning the term “gravity of the matter” as the primary factor influencing whether or not to disclose the matter to an appropriate authority. In this regard, the Task Force has taken up a suggestion made at the roundtables to consider U.S. Securities and Exchange Commission (SEC) regulation governing the obligations of attorneys who learn of client misconduct. Specifically, one provision of the regulation permits (but does not require) attorneys representing an issuer to breach their attorney-client confidentiality obligations as follows:

An attorney appearing and practicing before the Commission in the representation of an issuer may reveal to the Commission, without the issuer's consent, confidential information related to the representation to the extent the attorney reasonably believes necessary:

- (i) To prevent the issuer from committing a material violation that is likely to cause substantial injury to the financial interest or property of the issuer or investors;
- (ii) To prevent the issuer, in a Commission investigation or administrative proceeding from committing perjury, proscribed in 18 U.S.C. 1621; suborning perjury, proscribed in 18 U.S.C.

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<sup>7</sup> Section 140, *Confidentiality*

1622; or committing any act proscribed in 18 U.S.C. 1001 that is likely to perpetrate a fraud upon the Commission; or

- (iii) To rectify the consequences of a material violation by the issuer that caused, or may cause, substantial injury to the financial interest or property of the issuer or investors in the furtherance of which the attorney's services were used.<sup>8</sup>

- 36. The Task Force believes that the term “substantial injury” in the SEC regulation carries much more specificity than “gravity” and sets an appropriately high hurdle for auditors to clear in determining whether to override confidentiality to report suspected NOCLAR to an appropriate authority.
- 37. Accordingly, the Task Force proposes that the permission to override confidentiality be premised on the disclosure of the information being, in the PA’s professional judgment, necessary to prevent or rectify *substantial injury* to the public, for example, in circumstances of suspected NOCLAR.

#### *Obtaining Legal Advice and Third Party Test*

- 38. The Task Force believes that two further elements are necessary in the framework for auditors when considering the further action required and whether it will be sufficient in the circumstances:
  - Obtaining legal advice. In this regard, the Task Force has noted the strong views expressed at the three roundtables that in many cases, the decision whether or not to report the matter to an appropriate authority would be subject of legal advice. As a secondary consideration, the Task Force believes that it would be useful to suggest that auditors may seek advice from their professional bodies.
  - Applying a reasonable and informed third party test to objectively determine whether it would be likely that the further action would be effective in achieving the objectives of the standard. In this regard, the Task Force felt that it may not always be possible to find an effective solution to the issue and that the Code should acknowledge this reality.

#### **Matter for CAG Consideration**

- 3. Do Representatives agree with the Task Force’s proposals regarding auditors?

#### **Senior PAIBs**

##### *Overarching Expectations for Senior PAIBs*

- 39. One of the important messages from the roundtables is the need to emphasize the responsibilities of senior PAIBs in setting the right tone at the top and in establishing, to the best of their ability, the appropriate framework to prevent or deter the commission of NOCLAR within their organizations. The Task Force believes that this emphasis should be made in the Code, recognizing that the primary responsibility for ensuring that an entity conducts its business in full compliance with all applicable laws and regulations rests with management.
- 40. In this regard, the Task Force has taken note of the recent work of the Part C Task Force to seek to enhance the provisions of the Code applicable to PAIBs, and specifically that Task Force’s

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<sup>8</sup> U.S. SEC rule 17.C.F.R. Part 205—Standards of Professional Conduct for Attorneys Appearing and Practicing before the Commission in the Representation of an Issuer

proposal to amend paragraph 300.5<sup>9</sup> of the Code to read as follows – the intention being to provide expanded guidance regarding a senior PAIB’s role in the creation of an ethics-based culture within an organization (see Agenda Items G and G-2):

A professional accountant in business may hold a senior position within an organization. The more senior the position of the professional accountant, the greater the ability and opportunity there is to influence policies and decision-making. A professional accountant is expected to encourage an ethics-based culture in an employing organization. To the extent that the professional accountant is in a position to do so, the professional accountant shall take reasonable steps to identify, implement and oversee safeguards in the work environment to encourage or promote an ethics-based culture.

41. The Task Force believes that there is an opportunity to add a specific emphasis in such a provision with respect to NOCLAR and the prevention of NOCLAR, thereby helping to nudge a behavioral change among a group of PAs who are in a position to set the appropriate tone at the top and are able to ensure that the right things are done. The Task Force considers that this top-down approach would be an improvement over the current proposals which focus almost entirely on looking up the chain of command to ensure that the issue is appropriately addressed.
42. What would then remain would be to define this group of PAs. In this regard, the Task Force has considered the guidance in paragraph 290.134<sup>10</sup> of the Code (addressing threats to independence created by employment with an audit client) in tentatively defining a *senior* PAIB as follows:

A director, officer or employee able to exert significant influence over the preparation of accounting records or financial statements or compliance with laws and regulations.

#### **Matters for CAG Consideration**

4. Do Representatives agree with the Task Force’s proposals above? In particular, do Representatives support the proposed definition of a senior PAIB?

#### *Required Responses for Senior PAIBs*

43. Consistent with the feedback from the roundtables, the Task Force believes that senior PAIBs have a greater responsibility to take action in response to suspected NOCLAR than other PAIBs. The Task Force also believes that the response framework should be broadly comparable to that for auditors (see paragraphs 28-38 above) but with the following notable exceptions:
  - Senior PAIBs should be required, on a best efforts basis, to rectify, remediate or mitigate the consequences of NOCLAR when they come across it if it is other than clearly inconsequential.
  - They should also alert the external auditor in the spirit of transparency and because it is within their responsibility to inform the auditor of such matters.
44. The Task Force believes that the threshold for action should be similar to that for auditors under ISA 250, i.e., when the matter is other than clearly inconsequential. This threshold does not mean minor pilferages. Rather, it is framed by the description of the two categories of laws and regulation that circumscribe the scope of the proposals (see paragraph 16 above). Accordingly, these would

<sup>9</sup> Section 300, *Introduction*

<sup>10</sup> Section 290, *Independence – Audit and Review Engagements*

be matters of significance, particularly so given that they would concern potential breaches of laws and regulations.

45. Agenda Item E-3 summarizes the proposed response framework for senior PAIBs.

**Matter for CAG Consideration**

5. Do Representatives agree with the Task Force's proposals regarding senior PAIBs?

**PAAs in Public Practice Other than Auditors, and Other PAIBs**

46. For PAAs in public practice other than auditors and for other PAIBs, the Task Force believes that the extent of the required response should be less, consistent with their more limited spheres of influence. Accordingly, the Task Force proposes that:

- For PAAs in public practice other than auditors, they should only be required to:
  - Raise the matter with the client engagement lead partner as the baseline action if the matter could have significant consequences.
  - If they have access to higher levels of management/TCWG, inform them.
  - If the client is also an audit client, consider informing the lead audit engagement partner. This will depend on the potential significance of the matter in the context of the audit.
  - Stand back and consider if they can remain associated with the client in order to comply with the fundamental principles. This will depend on factors such as the response of management and TCWG, the likely consequences to those potentially affected, and the likelihood of continuing consequences.
- For other PAIBs, they should only be required to:
  - Escalate the matter to an immediate superior or another PAIB with the ability to evaluate the matter if it could have significant consequences; or
  - Use the established internal whistle-blowing procedure if available.

47. The Task Force believes that the above approach for PAAs in public practice other than auditors will address the concerns that a number of roundtable participants expressed regarding forensic accountants being scoped in under the current proposals.

48. Overall, the Task Force believes that this revised framework is responsive to the feedback received from the roundtables, balances the need to serve the public interest against considerations of global operability, and is proportionate having regard to the different roles and positions of PAAs. This revised approach would also respond to the many concerns that were expressed by respondents regarding the practical implementation difficulties and the potential for unintended consequences in the original ED.

**Matters for CAG Consideration**

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



**Material Presented – CAG Papers**

- Agenda Item E-1      NOCLAR Roundtables – Summary of Significant Feedback
- Agenda Item E-2      NOCLAR Roundtable Briefing Note
- Agenda Item E-3      NOCLAR – A Proposed Revised Framework

**Project History**

**Project: Responding to Non-Compliance with Laws and Regulations**

**Summary**

	<b>CAG Meeting</b>	<b>IESBA Meeting</b>
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 and development of revised proposals	April 2013 September 2013	March 2013 June 2013 September 2013 December 2013
Consideration of tentative revised proposals	March 2014	–
Updates regarding NOCLAR roundtables	–	April 2014 July 2014

**CAG Discussions: Detailed References**

<b>Project Commencement</b>	<p><u>March 2010</u></p> <p>See IESBA CAG meeting material:  <a href="http://www.ifac.org/sites/default/files/meetings/files/5271.pdf">http://www.ifac.org/sites/default/files/meetings/files/5271.pdf</a></p> <p>See CAG meeting minutes (section C of the following material):  <a href="http://www.ifac.org/sites/default/files/meetings/files/5699_0.pdf">http://www.ifac.org/sites/default/files/meetings/files/5699_0.pdf</a></p> <p><u>September 2010</u></p>
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	<p>See IESBA CAG meeting material:  <a href="http://www.ifac.org/sites/default/files/meetings/files/5676_0.pdf">http://www.ifac.org/sites/default/files/meetings/files/5676_0.pdf</a></p> <p>See CAG meeting minutes (section C of the following material):  <a href="http://www.ifac.org/sites/default/files/meetings/files/6002_0.pdf">http://www.ifac.org/sites/default/files/meetings/files/6002_0.pdf</a></p>
<p><b>Development of Proposed International Pronouncement (Up to Exposure)</b></p>	<p><u>March 2011</u></p> <p>See IESBA CAG meeting material:  <a href="http://www.ifac.org/sites/default/files/meetings/files/6011_0.pdf">http://www.ifac.org/sites/default/files/meetings/files/6011_0.pdf</a></p> <p>See CAG meeting minutes (section D of the following material):  <a href="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">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</a></p> <p><u>September 2011</u></p> <p>See IESBA CAG meeting material:  <a href="http://www.ifac.org/sites/default/files/meetings/files/20110831-IESBA%20CAG%20-%20Agenda%20Item%20C%20-%20Responding%20to%20a%20Suspected%20Illegal%20Act.pdf">http://www.ifac.org/sites/default/files/meetings/files/20110831-IESBA%20CAG%20-%20Agenda%20Item%20C%20-%20Responding%20to%20a%20Suspected%20Illegal%20Act.pdf</a></p> <p>See CAG meeting minutes (section C of the following material):  <a href="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">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</a></p> <p><u>March 2012</u></p> <p>See IESBA CAG meeting material:  <a href="http://www.ifac.org/sites/default/files/meetings/files/20120227-IESBA%20CAG%20-%20Agenda%20Paper%20D%20-%20Responding%20to%20a%20Suspected%20Illegal%20Act.pdf">http://www.ifac.org/sites/default/files/meetings/files/20120227-IESBA%20CAG%20-%20Agenda%20Paper%20D%20-%20Responding%20to%20a%20Suspected%20Illegal%20Act.pdf</a></p> <p>See CAG meeting minutes (section D of the following material):  <a href="http://www.ifac.org/sites/default/files/meetings/files/Agenda%20Paper%20A-1%20-%20Draft%20CAG%20Minutes.pdf">http://www.ifac.org/sites/default/files/meetings/files/Agenda%20Paper%20A-1%20-%20Draft%20CAG%20Minutes.pdf</a></p>
<p><b>Consideration of Respondents' Comments and Development of Revised Proposals</b></p>	<p><u>April 2013</u></p> <p>See IESBA CAG meeting material:  <a href="http://www.ifac.org/sites/default/files/meetings/files/Agenda%20Item%20B%20-%20Suspected%20Illegal%20Acts%20-%20Cover%20Note.pdf">http://www.ifac.org/sites/default/files/meetings/files/Agenda%20Item%20B%20-%20Suspected%20Illegal%20Acts%20-%20Cover%20Note.pdf</a></p> <p>See CAG meeting minutes (section B of the following material):  <a href="http://www.ifac.org/sites/default/files/meetings/files/Agenda%20Item%20A%20-%20Draft%20April%202013%20CAG%20Minutes%20(Mark-Up).pdf">http://www.ifac.org/sites/default/files/meetings/files/Agenda%20Item%20A%20-%20Draft%20April%202013%20CAG%20Minutes%20(Mark-Up).pdf</a></p>

	<p>See report back on April 2013 discussion in the following material: <a href="http://www.ifac.org/sites/default/files/meetings/files/Agenda%20Item%20F%20-%20SIA%20Report-Back%20and%20Issues.pdf">http://www.ifac.org/sites/default/files/meetings/files/Agenda%20Item%20F%20-%20SIA%20Report-Back%20and%20Issues.pdf</a></p> <p><u>September 2013</u></p> <p>See IESBA CAG meeting material: <a href="http://www.ifac.org/sites/default/files/meetings/files/Agenda%20Item%20F%20-%20SIA%20Report-Back%20and%20Issues.pdf">http://www.ifac.org/sites/default/files/meetings/files/Agenda%20Item%20F%20-%20SIA%20Report-Back%20and%20Issues.pdf</a></p> <p>See CAG meeting minutes (section F of the following material): <a href="http://www.ifac.org/sites/default/files/meetings/files/Agenda%20Item%20A-1%20-%20Draft%20September%202013%20CAG%20Minutes%20(mark%20up).pdf">http://www.ifac.org/sites/default/files/meetings/files/Agenda%20Item%20A-1%20-%20Draft%20September%202013%20CAG%20Minutes%20(mark%20up).pdf</a></p> <p>See report back on September 2013 discussion in the following material: <a href="http://www.ifac.org/sites/default/files/meetings/files/Agenda%20Item%20B%20-%20NOCLAR%20Report-Back%20and%20Issues.pdf">http://www.ifac.org/sites/default/files/meetings/files/Agenda%20Item%20B%20-%20NOCLAR%20Report-Back%20and%20Issues.pdf</a></p> <p><u>March 2014</u></p> <p>See IESBA CAG meeting material: <a href="http://www.ifac.org/sites/default/files/meetings/files/Agenda%20Item%20B%20-%20NOCLAR%20Report-Back%20and%20Issues.pdf">http://www.ifac.org/sites/default/files/meetings/files/Agenda%20Item%20B%20-%20NOCLAR%20Report-Back%20and%20Issues.pdf</a></p> <p>See CAG meeting minutes (section B of Agenda Item A-1).</p> <p>See report-back on March 2014 discussion in this agenda paper.</p>
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