

**Agenda Item****J-1****Meeting:** IESBA/IAASB CAG Joint Session**Meeting Location:** New York, USA**Meeting Date:** September 13, 2016

**Draft Minutes<sup>1</sup> of the Joint Public Session of the Meeting of the  
INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD's CONSULATIVE  
ADVISORY GROUP (IAASB CAG) AND INTERNATIONAL ETHICS STANDARDS BOARD FOR  
ACCOUNTANTS' CONSULATIVE ADVISORY GROUP (IESBA CAG)**

**Held on March 8, 2016  
Paris, France**

**[Marked for Changes Received From CAG After July 25, 2016 Circulation]**

**PRESENT****Member Organizations**

Kristian Koktvedgaard (IESBA CAG Chair)	BusinessEurope
Matthew Waldron (IAASB CAG Chair)	CFA Institute
Vânia Borgerth	Associação Brasileira d'Instituições Financeiras de Desenvolvimento
Nicolaas van der Ende	Basel Committee on Banking Supervision (Basel Committee)
Mohini Singh	CFA Institute
Dr. Juan-Maria Arteagoitia	European Commission (EC)
Noémi Robert	Fédération des Experts Comptables Européens (FEE)
Myles Thompson	FEE
Erik Bradbury	Financial Executives International (FEI)
Francis Nicholson	Institute of Internal Auditors (IIA)
Michael Stewart*	International Accounting Standards Board (IASB)
Jean-Luc Michel	International Association of Financial Executives Institutes – Europe, Middle East, and Africa Region (IAFEI-EMEA)
David Rockwell	International Bar Association (IBA)

<sup>1</sup> The draft minutes are for information only. The IESBA CAG and IAASB CAG have not yet reviewed them. They will approve these minutes at their September 2016 meetings.

\* Views expressed by the IASB Representative represent his views and do not necessarily reflect the view of the IASB.

Atsushi Inuma	International Organization of Securities Commissions (IOSCO)
Nigel James	IOSCO
Huseyin Yurdakul	IOSCO
Jim Dalkin	International Organization of Supreme Audit Institutions (INTOSAI)
Mauro Bini	International Valuation Standards Council (IVSC)
Jaseem Ahmed	Islamic Financial Services Board (IFSB)
Sherif Ayoub	IFSB
Kazuhiro Yoshii	Japan Securities Dealers Association (JSDA)
Gaylen Hansen	National Association of State Boards of Accountancy (NASBA)
Lucy Elliott	Organisation for Economic Cooperation and Development (OECD)
Irina Lopez	World Bank (WB)
Wei Meng	World Federation of Exchanges (WFE)

#### **Observer Organizations**

Dawn McGeachy-Colby	IFAC Small and Medium Practices (SMP) Committee
Simon Bradbury	International Monetary Fund (IMF)

#### **IAASB and IESBA Members and Staff**

Prof. Arnold Schilder	IAASB Chairman
Dr. Stavros Thomadakis	IESBA Chairman
Chuck Landes	IAASB Deputy Chair
Richard Fleck	IESBA Deputy Chair
Brendan Murtagh	IAASB Member
Prof. Annette Köhler	IAASB Member
Gary Hannaford	IESBA Member
James Gunn	Managing Director, Professional Standards
Kathleen Healy	IAASB Technical Director
Ken Siong	IESBA Technical Director
Beverley Bahlmann	IAASB Deputy Director
Nancy Kamp-Roelands	IAASB Deputy Director
Diane Jules	IESBA Deputy Director
Jasper van den Hout	IAASB Manager, Standards Development and Technical Projects

Kaushal Gandhi

IESBA Manager, Standards Development and Technical Projects

**Public Interest Oversight Board (PIOB)**

Michael Holm

**APOLOGIES**

Marie Lang

Dr. Obaid Saif Hamad Ali Al Zaabi

John Kuyers

Anne Molyneux

Patricia Miller

William Hines

Sanders Shaffer

Anusha Mohotti

Norio Igarashi

Martin Baumann

Lillian Ceynowa

**Member Organizations**

European Federation of Accountants and Auditors for SMEs (EFAA)

Gulf States Regulatory Authorities (GSRA)

Information Systems Audit and Control Association (ISACA)

International Corporate Governance Network (ICGN)

IIA

International Actuarial Association (IAA)

International Association of Insurance Supervisors (IAIS)

Sri Lanka Accounting and Auditing Standards Monitoring Board (SLAASMB)

**Observer Organizations**

Japanese Financial Services Agency (JFSA)

U.S. Public Company Accounting Oversight Board (PCAOB)

U.S. PCAOB

## Welcome Remarks

Messrs. Koktvedgaard and Waldron welcomed the Representatives and Observers.

### J1. Responding to Non-Compliance with Laws and Regulations (NOCLAR)

- To *DISCUSS* significant matters arising from the feedback on the:
  - (a) IESBA re-exposure draft and;
  - (b) IAASB exposure draft with related amendments to its ISAs and other standards
- To *OBTAIN* Representatives' and Observers' views on the IESBA and IAASB Task Forces' proposed responses  
(IESBA approval of the final document planned for March 2016. IAASB approval of final amendments planned for June 2016.)

#### MATTERS PERTAINING TO IESBA RE-EXPOSURE DRAFT

Mr. Fleck introduced the topic, highlighting the report-back in the agenda material regarding the September 2015 IESBA CAG discussion on the topic. IESBA CAG Representatives had no comments on the report-back.

Mr. Fleck then provided background to the project, recapping the journey traveled on this project since it was launched over six years ago. He outlined recent activities related to the project since the November/December 2015 IESBA meeting, including a meeting (jointly with IAASB representatives) with representatives of the Institut der Wirtschaftsprüfer (IDW) to listen to the IDW's concerns regarding the IESBA's and IAASB's NOCLAR-related proposals and to provide related explanations and clarifications. He highlighted the IESBA Task Force's intention to recommend that the IESBA commission the development of tools and resources to support implementation of the final NOCLAR proposals. He then summarized the tentative IESBA decisions on the project at the November/December 2015 IESBA meeting, and led Representatives through the matters for consideration.

The following matters were raised, among others.

#### *General Comments and Observations*

- Mr. Ahmed recognized the significant amount of hard work and challenging comments to address over the course of the project. He wondered about the observation from some respondents to the May 2015 IESBA NOCLAR Exposure Draft that it is not for Code to address NOCLAR but that this should be left to law or regulation to address. Mr. Fleck explained that some respondents share the view that the Code should mandate the disclosure of NOCLAR by professional accountants (PAs) to an appropriate authority, whereas other respondents believe that such disclosure matter should be left to law or regulation to address.
- Ms. McGeachy-Colby noted that the IFAC SMP Committee shared the same concerns as IDW regarding the potential for unintended consequences for audit quality as it felt that there was a de facto requirement to disclose NOCLAR to an appropriate authority under the proposals. She added that this is a very sensitive issue for SMPs. Mr. Siong explained why the Task Force did not share that concern.
- Mr. James highlighted that IOSCO Committee 1 was still considering the revised text. Accordingly, he noted that he would not be able to respond to all the matters presented for consideration during the session.

### *Third Party Test*

- Referring to comments from some respondents that the third party test is too subjective, Mr. James commented that his experience has been that such a test is challenging to enforce in a court of law with respect to auditor independence. He wondered what the IESBA's expectation was regarding enforceability by regulators in the context of NOCLAR. Mr. Fleck explained that the intention with respect to the Code is to inject an element of objectivity in the assessment of the particular matter at hand from a hypothetical person's perspective. Regarding enforceability of the test, he commented that regulators will assess how the PA has applied the test. Accordingly, a well-documented reasoning will be an important consideration. He added that the test is intended to make sure that the PA is not making a subjective decision about the matter but thinking about how others would approach it.
- Mr. James expressed the view that it would behoove the IESBA to consider jurisdictions where the test might not be enforceable, and therefore consider whether the test is the right approach. He acknowledged that the PA will need to step back in assessing a NOCLAR matter. However, he expressed a concern that a regulator might not be able to enforce the test based on his experience in the U.S. Mr. Fleck agreed that the third party test would force the PA to step back in assessing the matter.
- Noting that he understood Mr. Fleck's explanation regarding the third party test, Mr. Rockwell expressed some doubt about the case law Mr. James mentioned. Mr. Rockwell noted that when cases involving auditors arise in the U.S., the test that has been applied is a strict liability test, which is a much stricter test than the third party test. He added that in most high profile cases of lawsuit against auditors, the test has been a strict liability test, not a reasonableness test. Accordingly, he was of the view that there is quite a bright line in U.S. case law.
- Mr. Ahmed commented that the third party test is akin to a "check and balance" mechanism. He noted the statements in the Code to the effect that the Code cannot override laws and regulations. He added that ISAs and the Code need to be addressed at the level of guiding principles to allow jurisdictions to implement specific laws and regulations. Accordingly, if the third party test were not enforceable in law or regulation, he wondered whether there would be a need to take a more general vs. specific approach. Mr. Fleck emphasized that in exercising appropriate professional judgment, the PA would need to take into account the national context.
- Mr. Hansen noted that NOCLAR is a most difficult topic; however, there is a need to address it. He was of the view that the key is appropriate balance as the process of finalizing the provisions could be neverending. He noted that there is already a public expectations gap regarding PAs' responsibilities vis-à-vis NOCLAR, and not addressing the topic would only widen that gap. He believed that the proposals would enhance the reputation of the profession.
- Mr. Stewart indicated that he understood the practical approach to introduce an objective evaluation of the need for, and extent of, further action in the response framework. He noted that in the International Financial Reporting Standards (IFRS Standards), the approach is to think about the information needs of investors and other third party users, for example, taking into account a hypothetical market transaction when estimating fair values. While IFRS Standards may have a different purpose, he noted that the notion of a third party test is not dissimilar in that context. Mr. Siong highlighted the IESBA's current efforts under its Safeguards project to provide further guidance regarding the test to facilitate its consistent application.

- Mr. Dalkin commented that the third party test is not a “foreign” concept for auditors, especially in the governmental context. Accordingly, he was of the view that it is a reasonable approach to take.

#### *Scope of Matters Covered under the Proposed Sections*

Mr. Fleck explained the Task Force's proposed clarifications to the wording of the provisions addressing the scope of matters covered under the sections dealing with PAs in public practice and in business, pursuant to a comment from IOSCO Committee 1. Representatives broadly supported the Task Force's proposals and had no comment.

#### *Imminent Breach of a Law or Regulation*

Mr. Fleck explained the proposed new provision in response to a comment from IOSCO Committee 1 that would permit a PA to effectively bypass the response framework in order to make disclosure to an appropriate authority in exceptional circumstances where the PA has reason to believe that an imminent breach of a law or regulation would cause substantial harm to stakeholders. Representatives broadly supported the proposal.

The following matters were raised:

- Mr. Thompson wondered if the third party test would still apply in these circumstances. Mr. Rockwell noted that it is a bypass of the process. Accordingly, one has to form a judgment regarding imminence and substantial harm. He wondered, however, whether this circumstance would also be subject to the documentation requirement.
- Mr. Waldron wondered whether the phrase “may exercise professional judgment” should be amended to read “shall exercise professional judgment.” Mr. Fleck noted that the Task Force would reflect further on this suggestion.

#### *Communication with Respect to Group Audits*

Mr. Fleck explained the Task Force's proposals aimed at enhancing the provisions addressing communication with respect to group audits in response to feedback from IOSCO Committee 1. Representatives broadly supported the proposals.

The following matters were raised:

- Mr. Koktvedgaard noted that in some jurisdictions such as the EU, the audit committee at the parent entity is responsible for overseeing management of the entire group. He wondered whether such an audit committee would be covered under the concept of those charged with governance (TWCG) in the proposals. Mr. Fleck responded in the affirmative.

#### *Documentation by PAs other than Auditors*

Mr. Fleck explained the Task Force's rationale for not taking up the suggestion from IOSCO Committee 1 to make the documentation provisions for PAs providing services other than audits of financial statements as strong as that for auditors. Representatives broadly supported the Task Force's and the IESBA's views on this matter and had no comments.

#### *Communication Between Predecessor and Proposed Successor Auditors*

Mr. Fleck explained the Task Force's proposal, in response to a comment from IOSCO Committee 1, regarding not requiring client consent as a precondition for communication between a predecessor

auditor and a proposed successor auditor in circumstances where there has been a change of auditors as a result of a NOCLAR matter. Representatives broadly supported the proposal and had no comment.

### *Concluding Remarks*

Dr. Thomadakis noted that the constructive discussion had reinforced his conviction that the IESBA must complete the project. In this regard, he noted the importance of concluding whether the project had achieved an appropriate balance between the public interest objective and the need to have regard to the global application of the Code. He observed that many jurisdictions already have legal or regulatory reporting requirements and that the IESBA had taken care that the provisions in the Code not conflict with those requirements. However, the proposed provisions also represented a step forward for jurisdictions that do not currently have a requirement in law or regulation to report NOCLAR. He acknowledged that there still remains a range of views regarding the nature and extent of PAs' responsibilities in the Code for responding to NOCLAR, hence why the exercise of professional judgment would be critical and why the guidance the Code will provide would be so valuable.

Dr. Thomadakis added that in some respects, the provisions would be breaking new ground. Accordingly, the IESBA intended to review the effectiveness of application of the provisions post-implementation. Ultimately, he noted the need to fill a gap where laws and regulations do not address PAs' response to NOCLAR. Ms. Elliott agreed, noting that it would be Important to review experience post-implementation, and that the IESBA should be prepared to revisit the provisions if it appears that they are not working as effectively as intended. Mr. van der Ende concurred with Dr. Thomadakis, noting the support of the proposals from the Basel Committee on Banking Supervision.

### *Way Forward*

Mr. Fleck outlined the next steps in the project, noting that final approval of the provisions was planned for the latter part of April 2016, subject to the deliberations of the IAASB regarding consequential and conforming amendments to its standards as a result of the IESBA's NOCLAR proposals.

### **MATTERS PERTAINING TO IAASB EXPOSURE DRAFT WITH RELATED AMENDMENTS TO ITS STANDARDS**

Mr. Murtagh highlighted the significant comments received on the IAASB's Exposure Draft (ED) and the IAASB NOCLAR Task Force's recommendations thereon. He also indicated that the comments from IOSCO were not included in **Agenda Item J1-B1** but would be considered by the Task Force prior to the IAASB's June 2016 meeting and highlighted some of the key comments. Mr. Murtagh noted that the Task Force's main proposals related to the legal or ethical duty or right to report NOCLAR, the consistency between the IESBA NOCLAR ED and the IAASB's International Standards other than the International Standards on Auditing (ISAs), the definition of "non-compliance", the implications of NOCLAR for the auditor's report and group audits, the impact in jurisdictions who do not adopt, or plan to adopt, the Code of *Ethics for Professional Accountants* (Code) and responses regarding the future of ISA 250.<sup>2</sup>

The following matters were raised:

- Ms. Robert noted that the IAASB uses the word 'report' in relation to NOCLAR while the IESBA uses the word 'disclose' and questioned if this difference in wording has been considered by both Task Forces. Mr. Murtagh noted that it has been considered by the IAASB NOCLAR Task Force and that the Task Force was of the view that using the word 'disclose' could lead to confusion given

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<sup>2</sup> ISA 250, Consideration of Laws and Regulations in an Audit of Financial Statements

how that word is used in the IAASB's literature. Ms. Robert questioned if the IESBA NOCLAR Task Force should use the word 'report' to be consistent with the IAASB. Mr. Fleck responded that the IESBA NOCLAR Task Force will consider using the word 'report.'

- Ms. Robert agreed with the IAASB NOCLAR Task Force's recommendation not to make any changes to ISA 600<sup>3</sup> as the IAASB is currently consulting on ISA 600 and will shortly commence a project to revise the ISA. She questioned whether the IESBA NOCLAR Task Force should take a similar approach with respect to addressing group audits. Mr. Fleck responded that the IESBA standard is based on the concept that the IESBA NOCLAR requirements should enable the appropriate information about NOCLAR to reach the appropriate people irrespective of the audit environment. He further noted his view that the IESBA proposals are currently aligned with ISA 600 and if any changes are made to ISA 600 because of the project to revise ISA 600, the IESBA will consider if conforming amendments to Section 225 are needed.
- Mr. Rockwell noted that ISA 250 should also refer to the circumstances when there is a legal duty to report a matter to an appropriate authority but there is an ethical restriction, backed by some degree of legal weight, on that reporting. Mr. Murtagh responded that the IAASB NOCLAR Task Force will consider the matter.
- Mr. Rockwell questioned whether the phrase 'or may otherwise report' in requirement 28(c) should be a separate element and whether additional wording was needed to further clarify the intended application of the paragraph. He also noted that the reference in paragraph 28 which states '...without breaching the duty of confidentiality' could be better placed to improve the grammar of the paragraph, in light of his view that the auditor should first decide whether they should report the matter, and then determine whether reporting is not possible due to confidentiality. Mr. Murtagh noted that the IAASB NOCLAR Task Force will consider these matters.

Mr. Holm noted it was an interesting discussion on which he will report back to the PIOB. He highlighted that one of the matters that the PIOB might discuss is the IAASB's approach to make limited amendments to ISA 250. Given that the differences between the IESBA's and the IAASB's standards might be significant, he noted that the PIOB could request the IAASB to include a full revision of ISA 250 in its *Work Plan for 2017-2018* to ensure the two are fully aligned. Prof. Schilder noted that he is open for a discussion with the PIOB but highlighted that decisions would need to be made about the prioritization of topics to be included in the *Work Plan for 2017-2018*.

## **J2. Professional Skepticism (Agenda Item J2)**

To *OBTAIN* Representatives' and Observers' views on the questions relating to professional skepticism in the IAASB's Invitation to Comment (the ITC) *Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits*

Prof. Köhler introduced the topic by: (i) providing insight into the composition of the Professional Skepticism Working Group (PSWG), and the process for developing the professional skepticism (PS) section in the ITC; (ii) explaining the key messages in the ITC, including the graphic in the ITC that shows how PS as an attitude can drive actions; (iii) providing background on the questions raised in the ITC and on which the PSWG wishes to explore with the CAG; and (iv) referring back to the comments the PSWG received at the September 2015 CAG meeting.

<sup>3</sup> ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*



Mr. Fleck, the IESBA representative on the PSWG, provided an update on the latest developments with respect to PS within IESBA. He explained that PS is not a separate fundamental principle in the *Code of Ethics for Professional Accountants* (Code), but rather something that could be considered a component of a number of existing principles in the Code (e.g., independence, objectivity, integrity and due care). He noted his initial view that the IESBA could consider a project to review the section of the Code that sets out the conceptual framework and fundamental principles, with a view to explaining how PS plays an important role in helping the PA discharge the PA's obligations in accordance with the fundamental principles. He highlighted that this could be an appropriate way forward for the IESBA, subject to a project proposal being developed and the IESBA approving it. Dr. Thomadakis noted such a project would enable the IESBA to synthesize a number of important concepts in the Code and explain how the conceptual framework is intended to be applied, which would add to the value of the Code. Mr. Fleck also referred to the presentation the IESBA CAG had received the previous day from the Institute of Chartered Accountants in Scotland (ICAS) on the topic of moral courage and its interactions with the concepts of objectivity and independence.

The following matters were raised:

- Ms. Elliott expressed support for the potential project to be considered by the IESBA, noting that this could also address the different perceptions about the principles of independence and objectivity, provided that the various effects on other aspects of the Code were considered. Mr. Nicolson agreed. Mr. Ahmed noted the relevance of interconnections between concepts such as competence and integrity. Mr. Koktvedgaard expressed the view that a collective effort across the standard-setting Boards would be needed to enhance the application of PS.
- Mr. Hansen cautioned against being too prescriptive in addressing PS, drawing reference to earlier PCAOB exploration of a judgment framework. He noted that concerns had been expressed that it would be undesirable for a “check the box approach” to illustrate certain auditor actions. He suggested that emphasis on a thoughtful process for auditors to follow would be helpful, since PS is behavioral and not a binary mechanism that one can “turn on or off.” Mr. Fleck agreed that a process or a sequential approach that achieves PS cannot be established. He noted that efforts by the UK Financial Reporting Council and others to consider PS after the financial crisis were focused on PS as a mindset.
- Ms. Meng agreed that PS is closely connected to professional judgement and fundamental concepts in the Code. She added that it is difficult to evaluate whether PS has sufficiently been applied. She suggested a focus on whether the requirements and guidance that refer to PS are clear as to what is expected. She also suggested that consideration be given to whether it might be possible to develop acceptable criteria to evaluate whether the application of PS had been sufficient.
- Mr. Dalkin suggested the need to focus on the application of PS and not only on its definition. He suggested that the PSWG consider whether this can be a prerequisite for accepting an audit engagement. Mr. van der Ende added that the concept of PS must be made more tangible.
- Mr. Thompson noted that the concept of moral courage as addressed in the ICAS presentation the previous day is also very relevant in addressing PS as an attitude. He suggested that the PSWG consider academic research that suggested judgment frameworks might be useful tools for auditors in thinking about risks and biases.

- Mr. Ahmed drew attention to the various US Securities and Exchange Commission reports that addressed PS as a major issue, in particular as a result of the global financial crisis. He noted that an absence of PS could lead to the financial statements being materially misstated. Mr. Waldron noted the Toshiba case provided insight into areas where PS was not appropriately applied.
- Mr. Iinuma noted that the lack of an appropriately independent and challenging attitude is one of the reasons that fraud is overlooked, in particular if auditors are over-reliant on explanations by the entity. He suggested that the IAASB could provide more examples of how PS can be demonstrated, in particular with respect to fraud and other areas cited in inspection reports. Mr. Yoshii agreed. Mr. E. Bradbury also referred to PS as a state of mind and highlighted the link to the rationalization aspect in the fraud triangle, noting that it would be important to neutralize that by creating the right environment. He added that the basis for the appropriate application of PS is found in the behavior of the auditor and that it is therefore relevant to help frame this behavior.
- Mr. James highlighted a view within IOSCO that the auditor should be acting as a “sniffer dog” rather than a “watchdog,” suggesting that a change in how the auditor approaches certain areas is necessary. He gave the example of PS in the context of ISA 540,<sup>4</sup> suggesting that the IAASB should include a greater focus on testing management’s processes and not only confirming and corroborating evidence about management’s assertions, but also considering alternatives or contradictory evidence. He noted that this approach would represent a mindset of challenging management as opposed one of confirming management’s assertions. Mr. van der Ende agreed, noting that PS is a very important issue for the Basel Committee, as the lack of appropriate application of PS and exercise of professional judgement is persistent in various jurisdictions. He felt that there is a need to explore the related root causes. He also suggested that firms could do more to promote consistency in approach across clients.
- Mr. Ahmed noted that there can be many aspects that will undermine audit quality that can all be relevant and important, but that are distinct from PS. The focus should be about enhancing PS. He questioned the fact that if attitude is the critical issue, how it would relate to behavior and how behavior may lead to action such as more aggressive questioning or looking for contradictions, and the implications this may have for standard setting. He noted that it would be very valuable if one document would explain the lessons learned from experience from other disciplines where PS is also applied, the root causes for PS failure and the implications for standard setting.
- Mr. Dalkin noted that, although it is important to have consistency in the interpretation of PS within the profession, it should be acknowledged that in a governmental environment there may be a different focus for applying the concept of PS given public expectations. Mr. Ahmed also noted that PS is applicable to all kinds of professions, not just the accountancy profession. He suggested that the IAASB and the CAGs should be very clear about the context in which they are using PS.
- Mr. van der Ende noted that the auditor is expected to apply PS to a broader time horizon, as some of the decisions taken today may have significant consequences for future financial statements. For example, the switch from an incurred loss model to an expected credit loss (ECL) model for loan losses requires the auditor to assess several new assumptions that, once set, are more difficult to challenge. He reiterated the need for banks to have robust internal systems to move towards an ECL model and the concern that the use of an ECL could lead to increased earnings management, which is why PS from auditors in this area will be particularly important.

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<sup>4</sup> ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

- Mr. Rockwell expressed the view that PS is an attitude that is best to be developed early in one's professional career. He was pleased that the International Accounting Education Standards Board (IAESB) is involved in the PSWG. Mr. van der Ende agreed. Mr. S. Bradbury also noted the relevance of having, at the start of one's career, a skeptical mindset. He suggested that firms' recruitment policies be assessed.
- Mr. Yoshii commented that education is important. He added that the lack of understanding of the business, especially in certain industries, is one of the reasons that auditors are not applying PS sufficiently or are criticized for not finding misstatements. He suggested that the PSWG consider the linkage between PS and ISA 315<sup>5</sup> as a means of reinforcing the importance of auditors understanding the entity's business as well as the industry. Mr. Koktvedgaard agreed with the relevance of education and noted that confidence occurs when one has the knowledge of the business, which allows for greater skepticism. Mr. Bini highlighted the linkage between knowledge and PS. He noted that valuation is very complex and that knowledge helps the auditor raise the proper critical questions.
- Mr. Rockwell wondered whether there is a way to emphasize to audit firms that they should strengthen their management processes. Mr. Linuma suggested prioritization of the areas that the PSWG is exploring as explained in paragraph 37 of the ITC. He noted his agreement with the potential steps forward as described in paragraph 38-40 of the ITC. Most important, in his view, is International Standard on Quality Control (ISQC) 1, as this standard provides a basis for focusing on audit firms' culture and the need to challenge management; the importance of sufficient and practical education; and sufficient audit resources to support an engagement (for example, staff time available and skills of the engagement team). Mr. James expressed the view that the "tone at the middle" is important, noting that, while the tone at the top is fundamental, the senior staff of individual engagements influence audit quality.
- Mr. Rockwell was of the view that the current model of the accountancy profession and economic pressure are impediments to take into account. Mr. James encouraged the PSWG to dig deeper and explore the root causes of the lack of PS, which may include a lack of appropriate resources and budget constraints. Mr. E. Bradbury added that fee pressure and negative incentives play a role too. Mr. Stewart referred to the relevance of considering management's perspective in setting realistic timetables for reporting. He also noted that PS is affected by the complexity of transactions and that both management and the auditor need to acknowledge this complexity.
- Mr. Koktvedgaard agreed with challenging management assertions as noted in paragraph 17 of the ITC, but noted that there are financial reporting deadlines and that a trade-off has to be made whether it is worth postponing the auditor's report to allow the auditor to have more time to be more skeptical. Ms. Singh agreed there is a trade-off, but questioned whether investors would agree with receiving the auditor's report later, as this might lead to their unduly relying on earnings releases as a result. She suggested that auditors could use new technologies in the audit process that may reduce the time needed to audit financial statements, and thus allowing sufficient time for PS.
- Mr. van der Ende suggested that consideration be given to what others can do, taking into account the different environments in which PS is applied. He referred to IOSCO's Working Group on audit quality and the discussions in the Global Public Policy Committee (GPPC). Mr. Koktvedgaard also noted the role of management and audit committees in promoting the application of PS by auditors.

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<sup>5</sup> ISA 315, *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

Mr. Schilder provided a summary of the discussion. He also emphasized that the input highlighted the need for the PSWG to quickly move from discussions at a conceptual level. He conveyed his gratitude for the practical suggestions that had been given.

Ms. Köhler noted that the discussion and input received confirmed the relevance of the activities of the PSWG and highlighted the importance of having representatives from the IAASB, IESBA and IAESB working together to determine how the relevant issues could be addressed in a holistic manner. She provided an indication of potential deliverables in the short, medium and longer term. She thanked the CAGs for the various suggestions received and noted that they would be considered by the PSWG, together with the responses to the ITC.

### J.3 Working Lunch/ Open Session: Presentation from a Representative of OECD

To <i>RECEIVE</i> a presentation from a representative of the OECD
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Ms. Liz Owen thanked the CAGs for inviting her to speak, and provided a brief summary of her background and the work of the OECD Anti-Corruption Division. She then led the CAGs through a presentation titled, *The OECD Anti-Bribery Convention: Perspectives for Accountants and Auditors*.

Ms. Owen explained that the OECD Anti-Corruption Division's work since the 1999 OECD Anti-Bribery Convention<sup>6</sup> (the Convention) is focused on the detection of bribes and the enforcement of anti-bribery legislation. She noted that it is geared towards the "supply side" or payment of bribes, particularly by organizations, rather than on the receipt of bribes. She explained that the OECD's Working Group on Bribery performs evaluations of its 41 member countries to understand whether the country is well-equipped to detect bribery and enforce anti-bribery laws, including whether organizations have appropriate processes in place to detect and self-report acts or suspected acts of bribery and corruption. She also noted that the OECD Working Group makes recommendations to the evaluated country once each evaluation is completed.

Ms. Owen provided an overview of the Convention requirements and the specific recommendations, which include the need for an external audit by independent auditors, and protection for PAs, including auditors who report bribery and corruption. She then provided some statistical information to describe the profile of who bribes. She noted that based on a 2014 OECD Foreign bribery report, a little over 50% of cases of bribery involve corporate management, including CEOs; 75% of the cases involve intermediaries; two thirds of the cases occurred in four sectors: extractives, construction, transport, and IT and communications; and two-thirds of the cases involved bribes to developed countries.

Representatives expressed strong support for the work of the OECD Anti-Bribery Division. The following matters were raised, among others:

- Mr. Michel shared views about what could be done within entities to prevent bribery and to improve detection, and what tools might be needed to promote compliance with the Convention.
- Mr. E. Bradbury asked about the level of materiality that is being used during the internal audit process for purposes of detecting bribes. He noted that in any audit, there is a scope and that it is important that anything above that scoping threshold be detected and reported. Mr. Stewart

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<sup>6</sup> The OECD Anti-Bribery Convention establishes legally binding standards to criminalize bribery of foreign public officials in international business transactions and provides for a host of related measures that make this effective. It is the first and only international anti-corruption instrument focused on the 'supply side' of the bribery transaction.

wondered whether auditors were not reporting because the matters were immaterial. He noted that there is a qualitative aspect to materiality as well. Ms. Owen explained that materiality is an issue that is often discussed during many of the OECD's evaluations and that it varies among different countries. She also noted that it has been difficult for the OECD to draw conclusions from the work of auditors.

- Mr. Dalkin observed that the OECD's work requires consideration of laws and regulations across jurisdictions. Mr. James agreed and wondered about the number of bribery cases that should be, but are not being, reported. He also wondered whether certain aspects of the Code or the IAASB's standards could be enhanced to increase the reporting of instances of bribery and corruption. Ms. Owen responded that the OECD's surveys indicate that there are many allegations of bribery, but these allegations are often not being reported as actual bribery and corruption. Many cases are also confidential.
- Mr. Thompson noted that there is a significant focus in the EU on anti-money laundering, and auditor's related involvement. Ms. Owen explained that the Financial Action Task Force is responsible for developing the anti-money laundering requirements. Mr. Thompson observed that accounting firms are well positioned to support the OECD in this very important initiative.

Ms. Owen thanked the CAGs for their comments and indicated that she would report back to her colleagues and consider how to continue the dialogue among the OECD, IESBA and IAASB on matters of mutual interest. Messrs. Koktvedgaard and Waldron thanked Ms. Owen for her informative presentation.

### **Closing Remarks**

Messrs. Koktvedgaard and Waldron thanked the Representatives for their high level of participation and contributions to the discussions. They then closed the meeting.