



**Meeting:** IAASB–IESBA Joint CAGs

**Meeting Location:** New York

**Meeting Dates:** September 13, 2016

## Agenda Item J2

### Responding to Non-Compliance with Laws and Regulations (NOCLAR)— Report Back on IESBA and IAASB Projects

#### Objective of Agenda Item

1. To note the report-backs on the March 2016 joint session of the IAASB/IESBA CAGs regarding:
  - (a) The proposed amendments to the NOCLAR provisions to be included in the IESBA *Code of Ethics for Professional Accountants* (the Code) in the light of the significant comments received on the IESBA's May 2015 re-Exposure Draft, [Responding to Non-Compliance with Laws and Regulations](#) (re-ED); and
  - (b) The proposed amendments to ISA 250<sup>1</sup> and related conforming amendments to other IAASB International Standards addressing NOCLAR, in the light of the significant comments received on the IAASB's July 2015 Exposure Draft, [Responding to Non-Compliance or Suspected Non-Compliance with Laws or Regulations](#) (ED-ISA 250).

#### Status and Timelines for the IESBA and IAASB Projects

2. History details with respect to the IESBA and IAASB projects, including links to the relevant IESBA CAG and IAASB CAG documentation, are included in Appendices 1 and 2 respectively.

#### *Activities since March 2016 Joint Session of the CAGs*

##### IESBA

3. At its March 2016 meeting, the IESBA agreed in principle the final NOCLAR provisions to be included in the Code, including conforming amendments to relevant sections of the Code, subject to the deliberations of the IAASB at its March 2016 meeting regarding the NOCLAR-related amendments to its International Standards.
4. At its April 2016 teleconference, the IESBA approved the final NOCLAR provisions for the Code, taking into account the outcome of the March 2016 NOCLAR-related IAASB deliberations.
5. The PIOB approved due process at its June 2016 meeting and the pronouncement was issued in mid-July 2016. It will become effective on July 15, 2017, with early adoption permitted.
6. At its June 2016 meeting, the IESBA agreed to commission its staff to develop a number of tools and resources to raise awareness of the new pronouncement and to facilitate its effective implementation.

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<sup>1</sup> ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*

In this regard, a number of short video presentations were released with the pronouncement in mid-July together with the Basis for Conclusions, a fact sheet and an At-a-Glance publication.

7. Additional materials will produced and released over the next 6-12 months, resources permitting, including additional video presentations, Q&As and PowerPoint slides.

#### IAASB

8. The following provides a brief summary of the IAASB's activities since the March 2016 joint session of the CAGs:
  - (a) March 2016 meeting – Discussion of responses to the ED and Task Force recommendations.
  - (b) April 2016 teleconference – Further discussion of responses to the ED and Task Force recommendations.
  - (c) June 2016 meeting – The IAASB approved ISA 250 (Revised) and the conforming amendments to other International Standards, as included in **Agenda Item J2-A**.
9. The due process related to the IAASB's NOCLAR project will be considered by the PIOB at its September 2016 meeting. ISA 250 (Revised) will be effective for audits of financial statements of periods beginning on or after December 15, 2017, with a similar effective date for the amendments to the other IAASB International Standards.

#### March 2016 Joint CAGs Discussion

10. Extracts from the draft minutes of the March 2016 session of the joint CAGs<sup>2</sup> relating to matters raised, as well as an indication of how the IESBA, the IAASB or their respective Task Forces have responded to the Representatives' comments, are included in the tables below.

#### Matters Pertaining to the IESBA Re-ED

Matters Raised	Task Force/IESBA Response
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 the Code to address NOCLAR but that this should be left to law or regulation to address.	<p>Point not accepted.</p> <p>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.</p> <p>The IESBA believes that it is within the remit of the Code to address PAs' ethical responsibility to respond to NOCLAR, and this has been broadly</p>

<sup>2</sup> The draft minutes will be approved at the September 2016 joint CAGs meeting.

Matters Raised	Task Force/IESBA Response
	supported by all stakeholder categories. However, the fact that the Code addresses such responsibility does not mean that PAs need not comply with applicable laws and regulations governing their response to NOCLAR. PAs have a duty to comply with both laws and regulations, and the Code, whichever is more stringent.
<p>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.</p>	<p>Point not accepted.</p> <p>Mr. Siong explained why the Task Force did not share that concern.</p> <p>The IESBA does not share the view that there is a de facto disclosure requirement. In particular, the reasonable and informed third party test is not intended to be read narrowly as creating a de facto requirement to disclose in all or certain circumstances. Whether disclosure would be called for will depend on an objective assessment of the specific facts and circumstances at the time. The reasonable and informed third party test is intended to bring a degree of objective rigor to the PA's assessment, and not to force the PA to disclose regardless of the particular facts and circumstances at the time.</p>
REASONABLE AND INFORMED THIRD PARTY TEST	
<p>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.</p>	<p>Point not accepted.</p> <p>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.</p>
<p>Mr. James expressed the view that it would behoove the IESBA to consider jurisdictions where the test might not be enforceable, and therefore</p>	<p>Point not accepted.</p>

Matters Raised	Task Force/IESBA Response
<p>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.</p> <p>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.</p>	<p>The reasonable and informed third party test is not a new test as it already is an integral part of the conceptual framework in the Code and is used in various sections of the Code, including with respect to the definition of independence. Accordingly, it has been an essential part of the application and enforcement of the Code.</p>
<p>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.</p>	<p>Point taken into account.</p> <p>Mr. Fleck emphasized that in exercising appropriate professional judgment, the PA would need to take into account the national context.</p>
<p>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.</p>	<p>Support noted.</p>

Matters Raised	Task Force/IESBA Response
<p>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.</p>	<p>Point noted.</p>
<p>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.</p>	<p>Support noted.</p>
<p>IMMINENT BREACH OF A LAW OR REGULATION</p>	
<p>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.</p>	<p>Point taken into account.</p> <p>The provisions do not require the application of the reasonable and informed third party test in these circumstances. The IESBA expects the PA to exercise appropriate professional judgment in good faith, and not be subject to “second-guessing.”</p> <p>This circumstance will be subject to the documentation requirement,</p>
<p>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.</p>	<p>Point accepted and change made to “shall exercise professional judgment.” See paragraph 225.36 in the final pronouncement.</p>

COMMUNICATION WITH RESPECT TO GROUP AUDITS	
Mr. Koltvedgaard 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 in the proposals.	Mr. Fleck responded in the affirmative.

*Matters Pertaining to the IAASB ED*

Matters Raised	Task Force/IAASB or IESBA Response
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. Ms. Robert questioned if the IESBA NOCLAR Task Force should use the word “report” to be consistent with the IAASB.	<p>Point not accepted.</p> <p>During the meeting, 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 how that word is used in the IAASB’s literature.</p> <p>Mr. Fleck responded that the IESBA NOCLAR Task Force would consider using the word “report.”</p> <p>The IESBA decided to use the term “report” with respect to references to legal or regulatory reporting requirements, as laws and regulations generally use that term in relation to such requirements. The IESBA decided to use the term “disclose” with respect to provisions specific to the Code.</p>
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.	<p>Point taken into account.</p> <p>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</p>

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

Matters Raised	Task Force/IAASB or IESBA Response
	consider if conforming amendments to Section 225 are needed.
<p>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.</p>	<p>Point taken into account.</p> <p>During the meeting, Mr. Murtagh responded that the IAASB NOCLAR Task Force will consider the matter.</p> <p>The IAASB explored various alternatives of how to articulate the auditor's determination of whether to report identified or suspected NOCLAR to an appropriate authority outside the entity. The IAASB recognized that reporting responsibilities under law, regulation or relevant ethical requirements differ, and it is not possible to encapsulate all of these succinctly in a requirement without making it overly complex. Accordingly, the IAASB agreed to retain a simple requirement that generally covers the possible reporting responsibilities that may exist (<i>see paragraph 29 of Agenda Item J2-A</i>). The IAASB also believed that it should be clear that the ISAs require the auditor to determine what provisions are contained in law, regulation or relevant ethical requirements regarding reporting of identified or suspected NOCLAR, and that any reporting would be in accordance with such law, regulation or relevant ethical requirements. This requirement is supported by application material that further explains the possible scenarios that may exist in terms of law, regulation or relevant ethical requirements, including consideration of confidentiality requirements under law, regulation or relevant ethical requirements that may preclude reporting to an appropriate authority (<i>see paragraphs A28–A33 of Agenda Item J2-A</i>).</p>
<p>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,</p>	<p>Point taken into account.</p> <p>During the meeting, Mr. Murtagh noted that the IAASB NOCLAR Task Force will consider these matters.</p> <p>Please refer to the IAASB's considerations and conclusions above.</p>

Matters Raised	Task Force/IAASB or IESBA Response
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 .	Furthermore, the IAASB determined that including the consideration of the duty of confidentiality in the requirement would create confusion for auditors and it is more application material in nature. Accordingly, the IAASB agreed that the considerations relating to confidentiality should be located in application material ( <i>see paragraph A32 of Agenda Item J2-A</i> ).

#### Material Presented – IAASB CAG PAPERS

Agenda Item J2-A                      ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements* and Related Conforming Amendments to Other International Standards

#### FOR IESBA CAG REFERENCE PURPOSES ONLY

Final IESBA NOCLAR pronouncement, [\*Responding to Non-Compliance with Laws and Regulations\*](#)



## Appendix 1

### IESBA Project History

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

##### Summary

	IESBA 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 – 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
Consideration of input received from roundtables and proposed NOCLAR response framework	September 2014	October 2014
Consideration of refinements to proposed framework	–	January 2015
Consideration of final draft of re-Exposure Draft	March 2015	April 2015
Re-exposure	May – September 2015	

	IESBA CAG Meeting	IESBA Meeting
Update on re-ED responses	September 2015	–
Consideration of significant comments on re-ED	March 2016	December 2015 March 2016
Approval		April 2016

### **IESBA CAG Discussions: Detailed References**

<b>Project Commencement</b>	<p><u>March 2010</u> See IESBA CAG meeting material <a href="#">here</a> and CAG meeting <a href="#">minutes</a> (section C).</p> <p><u>September 2010</u> See IESBA CAG meeting <a href="#">material</a> and CAG meeting <a href="#">minutes</a> (section C).</p>
<b>Development of Proposed International Pronouncement (Up to Exposure)</b>	<p><u>March 2011</u> See IESBA CAG meeting <a href="#">material</a> and CAG meeting <a href="#">minutes</a> (section D).</p> <p><u>September 2011</u> See IESBA CAG meeting <a href="#">material</a> and CAG meeting <a href="#">minutes</a> (section C).</p> <p><u>March 2012</u> See IESBA CAG meeting <a href="#">material</a> and CAG meeting <a href="#">minutes</a> (section D).</p>
<b>Consideration of Respondents' Comments and Development of Revised Proposals</b>	<p><u>April 2013</u> See IESBA CAG meeting <a href="#">material</a> and CAG meeting <a href="#">minutes</a> (section B). See <a href="#">report back</a> on April 2013 discussion.</p> <p><u>September 2013</u> See IESBA CAG meeting <a href="#">material</a> and CAG meeting <a href="#">minutes</a> (section F). See <a href="#">report-back</a> on September 2013 discussion.</p> <p><u>March 2014</u> See IESBA CAG meeting <a href="#">material</a> and CAG meeting <a href="#">minutes</a> (section B). See <a href="#">report-back</a> on March 2014 discussion.</p> <p><u>September 2014</u> See IESBA CAG meeting <a href="#">material</a> and <a href="#">CAG meeting minutes</a> (section E).</p>

	<p>See <a href="#">report-back</a> on September 2014 discussion.</p> <p><u>March 2015</u></p> <p>See IESBA CAG meeting <a href="#">material</a> and <a href="#">CAG meeting minutes</a> (Section B).</p> <p>See <a href="#">report-back</a> on March 2015 discussion.</p>
<p><b>Consideration of Respondents' Comments on Re-ED and Development of Final Proposals</b></p>	<p><u>September 2015</u></p> <p>See <a href="#">presentation slides</a>.</p> <p><u>March 2016</u></p> <p>See IESBA CAG meeting <a href="#">material</a> and CAG meeting <a href="#">minutes</a> (Section J1).</p> <p>See report back on the March 2016 discussion in this agenda item.</p>

## Appendix 2

### IAASB Project History

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

##### Summary

	IAASB CAG Meeting	IAASB Meeting
Project Commencement		March 2015
Project Proposal	June 2015	June 2015
Exposure Draft	June 2015 September 2015	June 2015 December 2015 (IESBA presentation)
Consideration of Comments Received on Exposure Draft	March 2016	March 2016 April 2016 June 2016
Approval		June 2016

##### IAASB CAG Discussions: Detailed References

Project Proposal	<p><u>June 2015</u></p> <p>See IAASB CAG meeting material:  <a href="http://www.iaasb.org/system/files/meetings/files/20150610-iaasb-cag-agenda_item_a1_noclar-pp-final.pdf">http://www.iaasb.org/system/files/meetings/files/20150610-iaasb-cag-agenda_item_a1_noclar-pp-final.pdf</a></p> <p>See CAG final approved meeting minutes:  <a href="http://www.iaasb.org/system/files/meetings/files/IAASB_CAG_June_2015_Teleconference_Minutes-approved.pdf">http://www.iaasb.org/system/files/meetings/files/IAASB_CAG_June_2015_Teleconference_Minutes-approved.pdf</a></p> <p>See report back on June 2015 CAG meeting included in paragraph 4 of the following:  <a href="http://www.iaasb.org/system/files/meetings/files/20150915-IAASB_CAG_Agenda_Item_E-NOCLAR_Reportback-final.pdf">http://www.iaasb.org/system/files/meetings/files/20150915-IAASB_CAG_Agenda_Item_E-NOCLAR_Reportback-final.pdf</a></p>
Exposure Draft	<p><u>June 2015</u></p> <p>See IAASB CAG meeting material:  <a href="http://www.iaasb.org/system/files/meetings/files/20150610-iaasb-cag-agenda_item_a_noclar-final.pdf">http://www.iaasb.org/system/files/meetings/files/20150610-iaasb-cag-agenda_item_a_noclar-final.pdf</a>  <a href="http://www.iaasb.org/system/files/meetings/files/20150610-iaasb-cag-agenda_item_a2_noclar_draft_ed-final.pdf">http://www.iaasb.org/system/files/meetings/files/20150610-iaasb-cag-agenda_item_a2_noclar_draft_ed-final.pdf</a></p> <p>See CAG final approved meeting minutes:  <a href="http://www.iaasb.org/system/files/meetings/files/IAASB_CAG_June_2015_Teleconference_Minutes-approved.pdf">http://www.iaasb.org/system/files/meetings/files/IAASB_CAG_June_2015_Teleconference_Minutes-approved.pdf</a></p>

	<p>See report back on June 2015 CAG meeting included in paragraph 4 of the following: <a href="http://www.iaasb.org/system/files/meetings/files/20150915-IAASB_CAG_Agenda_Item_E-NOCLAR_Reportback-final.pdf">http://www.iaasb.org/system/files/meetings/files/20150915-IAASB_CAG_Agenda_Item_E-NOCLAR_Reportback-final.pdf</a></p> <p><u>September 2015</u></p> <p>See IAASB CAG meeting material: <a href="http://www.iaasb.org/system/files/meetings/files/20150915-IAASB_CAG_Agenda_Item_E-NOCLAR_Reportback-final.pdf">http://www.iaasb.org/system/files/meetings/files/20150915-IAASB_CAG_Agenda_Item_E-NOCLAR_Reportback-final.pdf</a></p> <p>See CAG final approved meeting minutes: <a href="http://www.iaasb.org/system/files/meetings/files/IAASB_CAG_September_2015_Public_Session_Meeting_Minutes_Approved.pdf">http://www.iaasb.org/system/files/meetings/files/IAASB_CAG_September_2015_Public_Session_Meeting_Minutes_Approved.pdf</a></p>
Consideration of Comments Received on Exposure Draft	<p><u>March 2016</u></p> <p>See IAASB CAG meeting material: <a href="http://www.iaasb.org/cag/meetings/paris-france">http://www.iaasb.org/cag/meetings/paris-france</a></p> <p>See draft CAG meeting <a href="#">minutes</a>.</p> <p>See report back on the March 2016 discussion in this agenda item.</p>