

IAASB PROJECT PROPOSAL—LIMITED AMENDMENTS IN RESPONSE TO THE IESBA'S PROJECT REGARDING RESPONDING TO NON-COMPLIANCE WITH LAWS AND REGULATIONS

I. Subject

1. This project considers the implications of the International Ethics Standards Board for Accountants' (IESBA's) project to develop new standards for its Code of Ethics for Professional Accountants (IESBA Code) regarding responding to non-compliance with laws and regulations (NOCLAR) on the IAASB's International Standards.¹

II. Background and Relevant Developments

2. In providing a professional service to a client or carrying out professional activities for an employer, a professional accountant (including an auditor or an assurance practitioner)² may come across an act or suspected act of NOCLAR. Such an act may have been committed or may be about to be committed by the client or employer, or by those charged with governance (TCWG), management or employees of the client or employer. The IESBA noted that the professional accountant has a prima facie ethical responsibility not to turn a blind eye to identified or suspected NOCLAR. At the same time, the IESBA recognized that such a situation can often be a difficult and stressful one for the professional accountant. The IESBA therefore approved a [project proposal](#) in 2010 to develop enhancements to the IESBA Code to help guide the professional accountant in dealing with the situation and in deciding how best to act in the public interest in these circumstances.
3. Among other matters, the project sought to address: whether identified or suspected NOCLAR should be disclosed to an appropriate authority in certain circumstances, having regard to the duty of confidentiality under the IESBA Code; the process for responding to identified or suspected NOCLAR; the threshold for taking action; and documentation. The IESBA released an Exposure Draft (ED), [Responding to a Suspected Illegal Act](#) in August 2012. In response to significant stakeholder concerns regarding the proposals in this ED, the IESBA revised the proposals and issued a second Exposure Draft (Re-ED), [Responding to Non-compliance with Laws & Regulations](#), in May 2015. The comment period on this closes on September 4, 2015.
4. The IESBA is aiming to close off the proposed standards under its extant drafting conventions ("close-off document") by the Q1 2016. It then intends to restructure the close-off document in accordance with the new structure and drafting conventions for the IESBA Code, which it is currently developing under a separate project. No change in meaning is intended as part of this restructuring exercise. The restructured NOCLAR standards will be exposed for comment on the restructuring only. The IESBA is aiming to approve the restructured Code by Q4, 2016 with the effective date to be determined in due course.

¹ The IAASB's International Standards comprise the International Standards on Auditing (ISAs), International Standards on Review Engagements (ISREs), International Standards on Assurance Engagements (ISAEs), International Standards on Related Services (ISRSs), and International Standards on Quality Control (ISQCs).

² Henceforth, the term "auditor" is used to include both auditors and practitioners.

5. The IAASB has been kept apprised of developments on the IESBA project. In particular, at the March 2015 IAASB meeting, the Chair of the IESBA's NOCLAR Task Force briefed the IAASB on the near-final proposals in the draft second ED.
6. Under the NOCLAR proposals, the professional accountant would have the right to disclose an identified or suspected NOCLAR to an appropriate authority if the professional accountant determines that such disclosure is an appropriate course of action in the circumstances. If the professional accountant determines that such a disclosure is appropriate, this will not be considered a breach of the duty of confidentiality under Section 140 of the IESBA Code. Certain of the International Standards, however, contain material that does not explicitly recognize this proposed right to disclosure without breaching confidentiality under the NOCLAR proposals. For example, ISA 250 states that "[t]he auditor's professional duty to maintain the confidentiality of client information may preclude reporting identified or suspected non-compliance with laws and regulations to a party outside the entity."³ While this does not necessarily contradict the proposed right to disclose, it would not draw this proposed right to the attention of the auditor. Accordingly, there may be a perceived inconsistency in approach with the IESBA Code.
7. In light of the issuance of the second IESBA NOCLAR ED, potential changes to the International Standards may be warranted to address actual or perceived inconsistencies of approach, or the scope of laws and regulations considered, with the IESBA Code when the final NOCLAR revisions become effective. Failing to address these actual or perceived inconsistencies may raise questions among stakeholders regarding the clarity of the interaction between the International Standards and the auditor's (or practitioner's) ethical obligations.
8. Given the issuance of the IESBA's second ED, the IAASB agreed at its March 2015 meeting that it should consider issuing an ED of any warranted limited amendments to its International Standards on an expeditious basis and, if possible, before the close of the comment period on the current IESBA's ED on NOCLAR. This would enable stakeholders to consider any proposed limited amendments to the International Standards alongside the IESBA's NOCLAR proposals, thereby facilitating a coordinated review of, and response to, both IAASB and IESBA proposals by stakeholders.
9. An IAASB Working Group (WG) has been established to consider on a preliminary basis the nature and extent of the potential amendments to the International Standards, and to provide input to Staff in developing this project proposal. The WG includes a member of the IESBA's NOCLAR Task Force. In addition, since January 2015, the Chair of the IAASB's NOCLAR WG has acted as a correspondent member on the IESBA's NOCLAR Task Force.
10. The IAASB WG believes that prioritization of this project will be an efficient and effective use of the IAASB's resources as stakeholders will have the opportunity to consider both the IESBA's and the IAASB's proposals at the same time. The WG envisages that final amendments to the International Standards will take into account the final changes to the IESBA Code.
11. During the IAASB discussion in March 2015, IAASB members noted that the changes proposed by the IESBA would represent a fundamental change in the approach to confidentiality under the IESBA Code in this area. The NOCLAR proposals applicable to an auditor also include a wider range of examples of laws and regulations covered than the examples provided in extant ISA 250 and includes NOCLAR that may occur (whereas ISA 250 focusses on historical compliance). It was suggested that

³ ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, paragraph A19

the proposed changes to the IESBA Code might therefore raise questions about whether the extant ISA 250 needs a more fulsome review to consider the implications of that wider range of examples of laws and regulations and application to potential NOCLAR.

III. Project Objectives, Scope, Focus and How They Serve the Public Interest

Project Objectives

12. The project objectives are to:

- (i) Identify any actual or perceived inconsistencies of approach or scope between the NOCLAR proposals and the International Standards, including ISA 250;
- (ii) Develop amendments to the International Standards to address such inconsistencies to the extent considered appropriate to enable the International Standards to continue to be applied effectively together with the IESBA Code or to clarify and emphasize key aspects of the proposed revised IESBA Code in the International Standards; and
- (iii) Make other recommendations, as appropriate, including identifying other areas where further improvements may need to be considered in due course.

Project Scope

- 13. The IESBA's NOCLAR proposals are intended to address professional accountants' ethical responsibilities when they face an instance of NOCLAR or suspected NOCLAR in the course of performing their engagements for their clients. In particular, the proposals are not intended to set any specific requirements with respect to the performance of an audit or assurance engagement, nor interfere with or undermine the International Standards, including ISA 250.
- 14. The scope of this project therefore covers actual or perceived inconsistencies of approach and scope between the IESBA NOCLAR proposals and the International Standards. The WG is of the view that guidance in the form of International Practice Notes, Staff Alerts, or similar would not be an appropriate alternative to making amendments to the International Standards, as they would not adequately address the actual or perceived inconsistencies.
- 15. This project will not address other potential amendments to ISA 250 or other International Standards in an effort to achieve improvements in those Standards in the immediate term. However, the project Task Force may make other recommendations, as appropriate, regarding other aspects of ISA 250 where further improvements may need to be considered in due course (for example, under a future IAASB Work Program). The Explanatory Memorandum to the ED could be a vehicle for soliciting stakeholders' views as to whether there is merit in exploring any further areas identified by the project Task Force.

Focus of the Project

- 16. The project will focus on identifying the amendments to ISA 250 and other International Standards that may be needed to avoid actual or perceived inconsistencies with the NOCLAR proposals. On a

preliminary basis, the WG has identified a potential need for limited amendments to ISQC 1,⁴ ISA 220,⁵ ISA 240,⁶ ISA 260 (Revised),⁷ ISA 450,⁸ ISRE 2400 (Revised),⁹ and ISAE 3402.¹⁰

17. The purpose of these amendments would be to (a) ensure that the International Standards and the IESBA Code will be able to operate in conjunction with each other without conflict once the final NOCLAR standards become effective and (b) clarify and emphasize key aspects of the NOCLAR proposals in the International Standards.
18. These amendments are expected to be limited, as developing them does not involve re-consideration of the objectives, requirements and application material of ISA 250, or other International Standards, in their own right.

How the Project Serves the Public Interest

19. It is in the public interest that the IAASB's and the IESBA's standards be able to operate in concert and without confusion due to the many jurisdictions that utilize both. It is also important that the International Standards acknowledge and do not potentially undermine the enhancements that will be made to the IESBA Code as a result of the NOCLAR project—either through being inconsistent or through failing to draw appropriate attention to the revised requirements in the IESBA Code. Equally, it would not be in the public interest for practitioners to be placed in a situation where the IESBA Code required one approach but the ISAs, either in the requirements or the application material, did not support or recognize that approach.

IV. Outline of the Project

Major Issues that Will Be Addressed

20. Amendments to the International Standards, albeit expected to be minor, are necessary to resolve inconsistencies of approach or scope and to clarify and emphasize key aspects of the NOCLAR proposals in the International Standards.
21. Among other possible issues, the project includes consideration of:
 - (a) Whether relevant references within the International Standards to confidentiality continue to be appropriate in light of the NOCLAR proposals.
 - (b) Whether requirements to communicate with management should acknowledge that, in some circumstances, law or regulation may specifically prohibit alerting management, or other actions, which might prejudice an investigation by an appropriate authority into an identified or suspected NOCLAR (“tipping-off”).

⁴ ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

⁵ ISA 220, *Quality Control for an Audit of Financial Statements*

⁶ ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

⁷ ISA 260 (Revised), *Communication with Those Charged with Governance*

⁸ ISA 450, *Evaluation of Misstatements Identified During the Audit*

⁹ ISRE 2400 (Revised), *Engagements to Review Historical Financial Statements*

¹⁰ ISAE 3402, *Assurance Reports on Controls at a Service Organization*

Impact Analysis Considerations

22. The primary benefit of this project is the avoidance of actual or perceived inconsistencies between the International Standards and the IESBA Code and to clarify and emphasize key aspects of the proposed revised IESBA Code in the International Standards. Of particular importance is the need to highlight that the auditor has the right, under some relevant ethical requirements, to disclose an identified or suspected NOCLAR to an appropriate authority if the auditor determines that such disclosure is an appropriate course of action in the circumstances. If that is the case, this will not be considered a breach of the duty of confidentiality under those relevant ethical requirements. Due to the anticipated limited nature of the amendments, the project is not expected to have a significant positive or negative impact on the cost of engagements covered by the International Standards beyond that necessary to implement the new IESBA Code. Conversely, failing to make the limited amendments may lead to confusion in practice regarding the interaction between the IESBA Code and IAASB's International Standards and, accordingly, may increase costs.

V. Implications for any Specific Persons or Groups

23. The project has implications for national standard setters (NSS) who have adopted the International Standards or elements thereof and auditors who use the International Standards or used them as the basis for their audit or other assurance engagement methodology.

VI. Development Process, Project Timetable and Project Output

Development Process and Project Timetable

24. Given the limited nature and scope of the anticipated amendments to the International Standards and the importance of providing stakeholders with an opportunity to consider the proposed amendments to the International Standards and the NOCLAR proposals side by side, this project will be undertaken on an expeditious basis as outlined in the proposed project timetable below. In particular, it is proposed that the amendments to the International Standards be issued for a 90-day comment period, given the benefits of aligning the IAASB's consideration of responses on the ED with the IESBA's consideration of comments on the second NOCLAR ED.¹¹
25. Due to the IESBA's intention to approve a restructured Code by Q4 2016, it will be necessary for the IAASB to approve the amendments to the International Standards in a close-off document. After the restructuring of the IESBA Code is complete, the project Task Force will review any final changes and make a recommendation to the IAASB regarding the approval of the amendments included in the close-off document.

Timing	Action
June 2015	Provide notice on the IAASB's website of the IAASB's consideration of the project at the June IAASB meeting

¹¹ Under the Due Process and Working Procedures, the exposure period for a draft international pronouncements issued by the IAASB will ordinarily be 120 days. A shorter exposure period may be set, for example, where in the public interest there is a need to conclude on a matter more quickly, the ED is relatively simple or short, or where the IAASB decides to re-expose all or only part of a draft international pronouncement.

Timing	Action
	Inform the Public Interest Oversight Board (PIOB) about the issue and of the intent to apply the Due Process in an accelerated manner
	Teleconference to obtain CAG input on project proposal and ED
	IAASB approval of project proposal and ED, with a 90-day comment period
	Full review of responses to the ED
December 2015	Report back from IESBA on responses to the second NOCLAR ED
	CAG consideration of ED responses and proposed amendments to the International Standards as a result of responses to the ED
March 2016	Report back from IESBA to IAASB about their ED responses and planned approach to finalizing the NOCLAR amendments
	IAASB discussion of proposed amendments to the International Standards as a result of revised based on responses to the ED
	IAASB approval of final amendments to the International Standards as a close-off document
First half of 2016	IESBA approval of restructured Code, including NOCLAR
December 2016	IAASB consideration of the need for any further changes to the International Standards as a result of IESBA approval of the restructured Code and, if so, final IAASB approval of amendments to the International Standards

26. The project will feature close interaction between the IAASB and IESBA, particularly in relation to comments on the IAASB ED and the current IESBA NOCLAR-ED. As this project is based on making amendments in light of the NOCLAR proposals, the final amendments to the International Standards will take into account the final NOCLAR standards approved by the IESBA. Accordingly, the IAASB and IESBA will interact at a staff, task force, or Board level as appropriate in relation to any comments on the respective EDs that may be relevant to either Board.

Project Output

27. The output of the project is anticipated to be amendments to requirements or application material in the International Standards. As noted in the objectives in paragraph 12, this project has only a limited scope and, therefore, amendments to the International Standards are expected to be limited as well. The Task Force may make further recommendations to the IAASB relative to the IAASB's consultation on its future Work Plans.
28. It is anticipated that the effective date of the amendments to the International Standards would be aligned to the effective date of the NOCLAR standards, which the IESBA will determine in due course.

VII. Resources Required

29. A project Task Force will be established, consisting of 4 IAASB members with an IESBA member as an observer. The project will be chaired by an IAASB member and supported by IAASB technical staff. It is expected that the members of the WG will continue as the project Task Force.