



Meeting: IAASB Consultative Advisory Group
Meeting Location: Teleconference
Meeting Date: June 10, 2015

Agenda Item

A

Responding to Non-Compliance or Suspected Non-Compliance with Laws and Regulations (NOCLAR)

Objectives of Agenda Item

1. To:
 - (a) Obtain Representatives' and Observers' views on the IAASB's project proposal regarding limited amendments to its International Standards in response to the International Ethics Standards Board for Accountant's (IESBA) Exposure Draft (ED) regarding responding to NOCLAR; and
 - (b) Obtain Representatives' and Observers' views on the draft IAASB ED prior to its planned issuance in July 2015.

Project Status and Timeline

IESBA Project

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)¹ 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 of Ethics for Professional Accountants* (IESBA Code); the process for responding to identified or suspected NOCLAR;

¹ Henceforth, the term "auditor" is used to include both auditors and practitioners.

the threshold for taking action; and documentation. The IESBA released an ED, *Responding to a Suspected Illegal Act*, in August 2012.

4. 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 the re-ED closes on September 4, 2015. This ED is included as a CAG Reference Paper for information. The IESBA CAG has discussed the NOCLAR project on a number of occasions, most recently at its March 2015 meeting.

Implications of the IESBA's Project to the IAASB

5. The IAASB has been following the IESBA project with interest. 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 250.² This is the first time the IAASB CAG has discussed the IAASB's proposed NOCLAR project.
6. At its March 2015 meeting, the IAASB establish a Working Group to consider whether amendments to the IAASB's International Standards are warranted in light of the IESBA's NOCLAR ED, and to propose such amendments. The IAASB noted that the Working Group need to consider whether the amendments should be limited to avoiding inconsistencies with the proposed revised IESBA Code, or whether the proposed revised IESBA Code indicates areas of the International Standards that may warrant further exploration by the IAASB in due course. It was noted that changes beyond the minimum to avoid inconsistencies between the International Standards and the revised IESBA Code may need to be considered as part of the IAASB's next work plan.
7. The IAASB Working Group developed responses to clarify the implications for the IAASB's International Standards of, and to emphasize in those standards, the changes made by IESBA regarding the professional accountants' obligations regarding NOCLAR, including confidentiality. These responses have benefited from the involvement of a member of the IESBA NOCLAR Task Force on the IAASB's Working Group, as well as IESBA staff.
8. Appendix 1 to this paper provides a project history.

² ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*

Matters for CAG Consideration

Section I – Project Proposal

Section I-A – Project Proposal Considerations

9. The project proposal has been reviewed by both the Steering Committee and the IAASB NOCLAR Working Group (see **Agenda Item A-1**). **The IAASB will be asked to approve this project proposal at its June 2015 meeting.**
10. The project objectives are to:
 - (a) Identify any actual or perceived inconsistencies of approach or scope between the NOCLAR proposals and the International Standards, including ISA 250;
 - (b) 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 applied with the IESBA Code or to clarify and emphasize key aspects of the proposed revised IESBA Code in the International Standards; and
 - (c) Make other recommendations, as appropriate, including identifying other areas where further improvements may need to be considered in due course.
11. The scope of this project covers actual or perceived inconsistencies of approach and scope between the IESBA NOCLAR proposals and the International Standards. 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).
12. The Working Group believes an expedited approach to this project is necessary and appropriate 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 IESBA's NOCLAR proposals side by side. As the proposed "Process to Address Circumstances Requiring an Accelerated Response" has not yet been finalized,³ Staff has evaluated the project proposal and noted that it incorporates the elements and steps of the proposed accelerated response process, which is aligned to the elements of the IAASB's normal due process. The Project Proposal includes a timetable detailing how the project is intended to proceed (see paragraph 25 of **Agenda Item A-1**).

³ Discussed with the IAASB CAG as Agenda Item I-1 of its March 2015 meeting

Section I-B – Implications of the Proposed Restructure of the IESBA Code

13. The IESBA is aiming to close off the proposed NOCLAR standards under its extant drafting conventions (termed a “close-off document”) by 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.⁴ No change in meaning is intended as part of this restructuring exercise. The restructured NOCLAR standards are intended to 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.
14. For information, “close-off documents” were used in the IAASB’s Clarity project to seek the Board’s approval of the final policy decisions and text of each ISA while the restructuring of the ISAs into their current form was undertaken. A close-off document means that the Board approves the text of the amendments to the standard, but does not issue the standard until the restructuring/redrafting process is complete. The restructuring or redrafting process is not intended to result in changes of meaning. The Standard-Setting Board (SSB) is then asked to approve the restructured standard, but does not further deliberate the content of the standard or re-discuss the policy positions set by the SSB in its approval of the close-off document.
15. Due to the IESBA’s intention to approve a restructured Code by Q4 2016, it is intended (based on the current IESBA timetable) that the IAASB will approve the amendments to the International Standards in a close-off document as well, in approximately Q1 2016. After the restructuring of the IESBA Code is complete, the project Task Force would then review the implications of the final changes to the IESBA Code arising from the restructuring and make a recommendation to the IAASB regarding the approval of the amendments included in the close-off document, in approximately Q4, 2016

Section II – Issues

Section II-A – Introduction to the Working Group’s Approach

Process

16. As noted in Section I of this paper, the proposed ED addresses only (i) actual or perceived inconsistencies of approach or scope to the extent considered appropriate to enable the International Standards to continue to be applied effectively, once the final IESBA NOCLAR standard becomes effective and (ii) amendments to clarify and emphasize key aspects of the proposed revised IESBA Code in the International Standards.
17. The Working Group reviewed the IESBA’s NOCLAR proposals, other than aspects that do not relate to the IAASB’s International Standards, such as the provisions for Professional Accountants in Business, and compared the proposals against relevant provisions of the International Standards.

⁴ www.ethicsboard.org/projects/structure-code

18. In its discussions, the Working Group focused on identifying issues and categorizing them by the Working Group's proposed response as follows:
- Category 1 – Amendments to address actual or perceived inconsistencies of approach or scope or to clarify and emphasize key aspects of the NOCLAR proposals, such as the changes to the confidentiality responsibilities. These changes are included in the proposed ED (see Section II-B of this paper).
 - Category 2 – Additional guidance material that might be considered helpful if added to ISA 250, or other International Standards, but is not considered to be of sufficient importance to warrant their inclusion in the ED as proposed amendments (as included in the CAG Reference Paper, Agenda 2-E of the June 2015 IAASB meeting). These items address matters such as the appropriate level of management or those charged with governance to which discussions should be addressed (covered in part by ISA 260) and material giving greater detail on the interactions with management or those charged with governance (which will be applicable via the IESBA Code so thus would be duplicative in the ISAs).
 - Category 3 – Areas for further consideration in a possible future revision of ISA 250. The Working Group identified other issues related to how the International Standards address the auditor's responses to NOCLAR (see paragraph 21 below). These issues may result in changes to the scope and approach of extant ISA 250. The Working Group does not believe these issues should be addressed at this time. The Working Group does, however, believe that respondents' consideration of the proposals in the ED, and future consideration of these issues by the IAASB, may be facilitated by highlighting these areas in the Explanatory Memorandum of the proposed ED as matters not addressed at this time, supported by an appropriate question for respondents.

Section II-B – Proposed ED

19. The Working Group's proposed amendments in the proposed ED included as **Agenda Item A-2** address the Category 1 issues described above and are drawn from, or based on, the IESBA's proposed amendments. Broadly, the proposed amendments can be characterized as follows:
- "Signpost" provisions that bring key aspects of the IESBA's NOCLAR proposals to the auditor's attention. For example ISA 250, paragraph 8a and ISA 240,⁵ paragraph 8a, highlight that the auditor may have additional obligations under relevant ethical requirements regarding NOCLAR which are proposed to change;

⁵ ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

- Proposed amendments to recognize and reflect the changes to the auditor's duty of confidentiality, particularly the right to disclose identified or suspected NOCLAR to an appropriate authority. See:
 - ISA 250, paragraph A19;
 - ISQC 1,⁶ paragraph A56;
 - ISA 240, paragraphs 43 and A65
 - ISRE 2400 (Revised),⁷ paragraph A92; and
 - ISAE 3402,⁸ paragraph A53;
- New guidance to clarify the implications of the IESBA's NOCLAR proposals for ISA 250, such as the possibility that the auditor may otherwise become aware of matters that the auditor is required to address under relevant ethical requirements, and which may have an effect on the audit. Illustrations of this type of proposed amendment are in ISA 250, paragraphs A12a and A17a. For example, if the auditor becomes aware of NOCLAR that the auditor is required to address under relevant ethical requirements, such non-compliance is relevant to the auditor's responsibilities under paragraphs 18-21 of ISA 250—for example, such non-compliance may cause the auditor to evaluate the integrity of management and, when appropriate, those charged with governance, even if the non-compliance does not have a material effect on the financial statements;
- New guidance to highlight the requirement in the IESBA NOCLAR ED for the auditor to communicate, prior to accepting the engagement, with the predecessor auditor—ISA 220,⁹ paragraph A8a;
- New guidance to recognize that laws or regulations may prohibit alerting (“tipping off”) the entity when, for example, the auditor is required to report the NOCLAR to an appropriate authority pursuant to money laundering legislation—ISA 240, paragraph A65; ISA 250, paragraph A19; ISA 260 (Revised),¹⁰ paragraph 7; ISA 450,¹¹ paragraph A8;

⁶ ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

⁷ ISRE 2400 (Revised), *Engagements to Review Historical Financial Statements*

⁸ ISAE 3402, *Assurance Reports on Controls at a Service Organization*

⁹ ISA 220, *Quality Control for an Audit of Financial Statements*

¹⁰ ISA 260 (Revised), *Communication with Those Charged with Governance*

¹¹ ISA 450, *Evaluation of Misstatements Identified During the Audit*

- Additional examples or explanatory material that the Working Group believes would be sufficiently significant in clarifying the text of applying the International Standards to warrant proposed amendments. For example:
 - ISA 250, paragraph A1a – highlights that management and those charged with governance may have additional responsibilities;
 - ISA 250, paragraph A7a – Includes examples of relevant laws and regulations drawn from the IESBA NOCLAR ED; and
 - ISA 250, paragraph A18a – Examples of circumstances that may cause the auditor to evaluate the reliability of written representations; and
 - Minor changes for consistency with the IESBA NOCLAR ED in ISA 250, paragraph 5.
20. The Working Group believes that these amendments address actual or perceived inconsistencies of approach or scope or clarify and emphasize key aspects of the NOCLAR proposals, and therefore propose to include them in the proposed IAASB ED.

Section II-C – Other Elements of the IESBA's NOCLAR ED

21. The Working Group also identified the following items in “Category 3,” as described in Section II-A of this paper. These items are listed below and are not included in the proposed ED, but are areas for possible future exploration:
- The distinction between the types of laws and regulations¹² and the different levels of work effort applied to each under extant ISA 250, and whether an alternative approach is warranted.
 - Whether ISA 250 should deal with all personal misconduct of those charged with governance, management, and employees related to the business activities of the entity.
 - Whether the list of agents (those charged with governance, management, and employees) in the definition of “non-compliance” in paragraph 11 of ISA 250 is sufficiently broad to include, for example, contractors and sub-contractors.
 - Whether ISA 250 should address making inquiries of management or, when appropriate, those charged with governance, regarding NOCLAR that “may occur” – which is included in IESBA's NOCLAR ED.

¹² ISA 250, paragraph 6, distinguishes the auditor's responsibilities in relation to compliance with two different categories of laws and regulations as follows: (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 such as 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.

- Whether ISA 250 should include a requirement to obtain an understanding of how management identifies and addresses known or suspected NOCLAR as an essential component in obtaining an understanding of the entity and its environment.
 - Whether ISA 620¹³ should require the auditor to include in the written agreement with an auditor's expert that the expert must inform the auditor if the expert becomes aware of NOCLAR in the entity.
 - How incidences of NOCLAR are communicated to the group engagement team. At the March 2015 IAASB meeting, the Working Group was asked to also consider this point. The Working Group discussed the issue and concluded that it is beyond the scope of the project proposal as it does not specifically relate to the IESBA's NOCLAR proposals.
22. In addition to these areas, respondents may have their own views on matters that may need to be considered in any future revision of ISA 250, and may have views on the urgency of the need to revise ISA 250.
23. The Working Group is therefore of the view that including a specific question on these matters in the Explanatory Memorandum would be helpful for the IAASB in developing its consultations on its future Work Plans and assessing the relative priority of any possible additional efforts relating to ISA 250 against other priorities.

Section III – Way Forward and Due Process

Section III-A – Opportunities for Further IESBA/IAASB Interaction

24. The IAASB's NOCLAR project will feature close interaction between the IAASB and IESBA, particularly in relation to comments received on the IAASB ED and IESBA Re-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, and Board level as appropriate in relation to any comments on the respective EDs that may be relevant to either Board.
25. While preparing the draft ED for this meeting, the Working Group noted that there were areas within the IESBA NOCLAR ED that the Working Group would seek to discuss further with IESBA to improve both the IESBA and the IAASB's understanding of the issues. Examples of areas for possible discussion include:
- Whether explicit or implicit references in the NOCLAR proposals to the IAASB International Standards are appropriate. For example, section 225.31 of the NOCLAR ED includes references to ISA 230's documentation requirements.
 - Whether there should be additional references to the impact of NOCLAR on the financial statements.

¹³ ISA 620, *Using the Work of an Auditor's Expert*

- Whether there are aspects of ISA 250 that would be useful additional material for inclusion in the IESBA NOCLAR material. One example is paragraph 23 of ISA 250 regarding communication of a matter to those charged with governance as soon as practicable when, in the auditor's judgment, non-compliance is believed to be intentional and material.

Section III-B – Exposure Period

26. As is evident in **Agenda Item A-2**, the proposed changes to the IAASB's International Standards are limited in nature. In addition, the Working Group notes that there would be benefit in finalizing the proposed changes to the IAASB's International Standards as timely as possible to align with the IESBA process as much as is feasible, given each Board's meeting schedules. Accordingly, the Working Group believes there is merit in a 90 day exposure period for the planned ED.¹⁴

Matters for CAG Consideration

1. Representatives are asked to share views on the following:
 - (a) Matters set out in the draft project proposal (Agenda Item A-1) to inform the IAASB's planned approval of the document at its June 2015 meeting;
 - (b) The nature and extent of the proposed changes to the International Standards (Agenda Item A-2) that, subject to IAASB discussion and approval, will be issued as an ED in July 2015;
 - (c) Whether the proposed 90-day exposure period would be appropriate in light of the limited nature of these changes; and
 - (d) Any other matters that would be relevant to the planned issuance of the ED.

Material Presented – IAASB CAG PAPERS

Agenda Item A-1	Project Proposal – Limited Amendments in Response to the IESBA's Project Regarding Responding to Non-Compliance with Laws and Regulations
Agenda Item A-2	Proposed IAASB ED

¹⁴ Although the exposure period for a draft international standard will ordinarily be no shorter than 120 days, a shorter or longer exposure period may be set when considered appropriate. 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 exposure draft is relatively simple or short, or where the IAASB decides to re-expose all or only part of a draft international standard.

Material Presented – IAASB CAG REFERENCE PAPERS

IESBA Exposure Draft Issued May 2015	http://www.ifac.org/publications-resources/responding-non-compliance-laws-regulations
Agenda Item 2 of the June 2015 IAASB Meeting – NOCLAR Cover	http://www.iaasb.org/system/files/meetings/files/20150616-iaasb-agenda_item_2-noclar_cover-final.docx
Agenda Item 2-D of the June 2015 IAASB Meeting – Category 1 Items: IESBA NOCLAR Exposure Draft vs. the IAASB's International Standards	http://www.iaasb.org/system/files/meetings/files/20150615-iaasb-agenda_item_2-d-category_1-final.pdf
Agenda Item 2-E of the June 2015 IAASB Meeting – Category 2 Items: IESBA NOCLAR Exposure Draft vs. the IAASB's International Standards	http://www.iaasb.org/system/files/meetings/files/20150615-iaasb-agenda_item_2-e-category_2-final.docx
Agenda Item 2-F of the June 2015 IAASB Meeting – Category 3 Items	http://www.ifac.org/system/files/meetings/files/20150615-iaasb-agenda_item_2-f-category_3-areas_for_future_consideration_in_250-final.pdf

Appendix 1

Project History

Project: Proposed Amendments to the IAASB's International Standards in Response to IESBA's NOCLAR Project

Summary

	CAG Meeting/ Teleconference	IAASB Meeting
Discussion of the IESBA's Project	Discussed previously at the IESBA CAG	December 2014 March 2015
Project Commencement	June 2015	June 2015
Development of Proposed International Standard (up to Exposure)	June 2015	June 2015