

Meeting: IAASB–IESBA Joint CAG

Meeting Location: Paris

Meeting Date: March 8, 2016

Agenda Item J1-A

Responding to Non-Compliance with Laws and Regulations (NOCLAR)— Report-Back and Issues

Objectives of Agenda Item

1. To note the report-back on the March and September 2015 CAG discussions.
2. To receive a brief overview of significant matters arising from the feedback on the IESBA re-Exposure Draft, [Responding to Non-Compliance with Laws and Regulations](#) (re-ED), and the IESBA's responses to them.
3. To obtain CAG Representatives' views on significant matters raised by IOSCO Committee 1 in its response to the re-ED, received after the closing date for comments.

Project Status (Including Coordination with IAASB) and Timeline

4. The IESBA approved the re-ED at its April 2015 meeting and issued it in May 2015. The comment period closed in early September 2015.
5. A preliminary update on the responses to the re-ED was provided at the September 2015 IESBA CAG meeting.
6. At its November 30–December 4, 2015 meeting, the IESBA considered the significant comments received on the re-ED and the Task Force's related responses (see Reference Papers 1 and 2 to Agenda Item J1).
7. At the December 7–11, 2015 IAASB meeting, the IESBA Task Force Chair briefed the IAASB on the outcome of the IESBA's deliberations the previous week. Subsequently, the IESBA Task Force Chair participated in an in-person IAASB NOCLAR Task Force meeting in February 2016, and related teleconferences in January and February 2016. The main objective of the IAASB Task Force meetings was to consider matters arising from the IAASB's July 2015 Exposure Draft [Responding to Non-Compliance or Suspected Non-Compliance with Laws and Regulations](#).
8. The Chairmen of the IAASB and IESBA, the IAASB and IESBA Task Force Chairs, and senior staff of the two boards have arranged to meet with the leadership and senior staff of Institut der Wirtschaftsprüfer (IDW) on February 25, 2016. In its response to the IAASB Exposure Draft, the IDW has raised a number of significant concerns regarding the IAASB's proposals and the application of the IESBA's proposals in the German context. The meeting is intended to provide a forum for the IAASB and IESBA representatives to listen to IDW's concerns and to allow an opportunity for them to provide explanations and clarifications regarding the two boards' proposals.

9. At the joint CAG session, the IAASB and IESBA Task Force Chairs will brief the two CAGs on the outcome of the meeting with IDW.
10. At its March 14–16, 2016 meeting, informed by the discussion at this joint CAG session, the IESBA will consider a revised draft of the proposed Sections 225¹ and 360,² and related consequential and conforming changes to other sections of the Code (“NOCLAR text”) with a view to closing off the NOCLAR text, pending the outcome of the IAASB’s consideration of the significant comments on the IAASB NOCLAR Exposure Draft. The IAASB is scheduled to meet in the same week as the IESBA, and its discussion of the topic has been scheduled for the day after the IESBA meeting. This is to allow the IESBA Task Force Chair to attend the IAASB session, to brief the IAASB on the outcome of the IESBA discussion, and to provide any explanations and clarifications relating to the IESBA proposals that may assist the IAASB’s deliberations.
11. The IESBA will then reconvene via teleconference in the latter part of April 2016 (at a date to be agreed) to receive an update from the IESBA Task Force Chair on the IAASB discussion. Subject to the outcome of that discussion, the IESBA will then be asked to vote to approve the NOCLAR text during that teleconference.
12. The Appendix to this paper provides a project history with respect to the IESBA, including links to the relevant IESBA CAG documentation.

March 2015 CAG Discussion

Below are extracts from the minutes of the March 2015 CAG meeting,³ and an indication of how the Task Force has responded to CAG Representatives’ comments

Matters Raised	Task Force/IESBA Response
<p>1. Ms. Gardner introduced the topic, outlining the most recent CAG and Board discussions on the project. Among other matters, she highlighted the strengths of the proposed framework for professional accountants (PAs) to respond to NOCLAR or suspected NOCLAR. She also noted that the proposed standard was intended to build on and complement ISA 250.⁴ In the context of the IESBA’s liaison with the IAASB in this regard, she would be attending the IAASB meeting the following week to present an update on the project. She then led the CAG through the issues presented.</p> <p>The following matters were raised.</p>	–

¹ Proposed Section 225, *Responding to Non-Compliance with Laws and Regulations*

² Proposed Section 360, *Responding to Non-Compliance with Laws and Regulations*

³ The minutes were approved at the September 2015 IESBA CAG meeting.

⁴ ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*

Matters Raised	Task Force/IESBA Response
GENERAL COMMENTS AND OBSERVATIONS	
<p>2. Ms. Elliott acknowledged the significant amount of effort that has gone into the project. She highlighted that the Organization for Economic Cooperation and Development (OECD) frequently encourages the signatory countries to its Anti-Bribery Convention to adopt its 2009 <i>Recommendation for Further Combating Bribery of Foreign Public Officials in International Business</i>, which strengthens its framework for fighting foreign bribery. She emphasized the importance of auditors responding appropriately to NOCLAR or suspected NOCLAR, and not turning a blind eye to it. In this regard, she highlighted a recent case in the Netherlands where a large firm was fined €7 million for effectively turning a blind eye to evidence of foreign bribery by one of its clients.</p>	<p>Ms. Gardner noted that the IESBA's aim is to have the Code drive PAs to do the right thing in the public interest. However, the IESBA was not discounting individual jurisdictions setting their own laws and regulations to address such issues.</p>
<p>3. Mr. Hansen noted that the draft rationale for the proposed framework was well thought out. He wondered whether there was a way to make it publicly available once the standard is finalized.</p>	<p>Mr. Siong noted that this suggestion would be considered by the IESBA in due course.</p>
<p>4. Ms. Lang suggested that the wording used in Ms. Gardner's presentation to describe the overall purpose of the framework (i.e. to guide PAs in deciding how best to serve public interest when they come across NOCLAR or suspected NOCLAR) would be useful in the introduction to the proposed standard.</p>	<p>Point not accepted.</p> <p>The Task Force and IESBA believe that the concept of serving the public interest has been appropriately expressed in the context of the specific objectives in paragraph 225.3⁵ and with reference to the PA's responsibility to act in the public interest.</p>
<p>5. Mr. Muis wondered whether there was an underlying value system in the proposals that could be promoted globally. He felt that it would be very important for PAs to face the public interest directly and respond appropriately, and not aid and abet non-compliance in</p>	<p>Ms. Gardner responded that the public interest is at the heart of this project and that the proposed standard provides a pathway to disclosure to an appropriate authority, and therefore for an override of the duty of confidentiality, in the appropriate circumstances. However, the IESBA also</p>

⁵ Paragraph numbers in this report-back refer to the [draft NOCLAR text](#) presented at the April 2015 IESBA meeting.

Matters Raised	Task Force/IESBA Response
<p>jurisdictions where laws and regulations are grossly violated. In this regard, he noted that while some legislators are good at addressing NOCLAR, others are less so.</p>	<p>recognized the need for the Code to operate in the context of local laws and regulations. She added that there is a need for the whole system to operate cohesively with all stakeholders playing their parts. In that context, she believed that the proposed standard was heading in the right direction.</p> <p>Dr. Thomadakis highlighted the distinct benefit to the bottom-up approach in the proposed standard, noting that this approach would work well in both jurisdictions that already have a legal or regulatory requirement for reporting of NOCLAR and those that do not. He added that the standard should not hinder reporting where required by law or regulation. At the same time, it should also not create a disincentive to reporting where this is not mandated under law or regulation.</p>
<p>6. Mr. Muis suggested that the explanatory memorandum to the re-exposure draft (re-ED) explain the dilemmas and the limits of what is possible under the proposed standard.</p>	<p>Point accepted. The explanatory memorandum laid out the challenges for auditors and other PAs in balancing confidentiality against disclosure to an appropriate authority in the public interest. It also outlined the rationale for why, unlike law or regulation, the IESBA believes that the Code cannot mandate such disclosure.</p>
<p>7. Mr. Michel expressed support for the direction of the proposed standard, noting that it was comprehensive.</p>	<p>Support noted.</p>
<p>8. Ms. Borgerth expressed support for the direction of the proposed standard. She noted that under Brazilian regulation, auditors are required to inform those charged with governance (TCWG) of instances of NOCLAR or suspected NOCLAR, and that TCWG in turn have legal responsibilities to address the matter.</p>	<p>Support and point noted.</p>
SCOPE	
<p>9. Mr. Hansen wondered why there should be a distinction between audits and reviews with respect to PAs in public practice, given that both types of services come under the umbrella</p>	<p>Point considered.</p> <p>The IESBA believes that the proposed differential approach is appropriate because the use of review engagements around the world varies significantly,</p>

Matters Raised	Task Force/IESBA Response
<p>of attest services and that PAs would also have access to TCWG when performing review engagements. Accordingly, he wondered whether the right split should not be between attest and non-attest services as opposed to audits and other services.</p>	<p>as does the level of public interest in them. There is similar wide variation in other assurance engagements that are not audits of financial statements. Also, lawmakers and regulators around the world have tended to legislate or regulate audits as opposed to other assurance engagements.</p> <p>The IESBA noted that jurisdictions would not be precluded from extending the proposed approach to review and other assurance engagements that are not audits, should they believe that doing so would be appropriate for their national contexts.</p>
<p>10. Mr. Fukushima noted improvement in the description of the scope of the proposed standard. However, he wondered whether an instance of NOCLAR that could undermine the reputation of the entity but which might not necessarily result in substantial harm to the public would be in scope. He suggested, as an example, insider trading which could have a significant impact from a public interest perspective. Mr. James commented that insider trading may have no direct or indirect effect on the financial statements.</p>	<p>Ms. Gardner noted that the Task Force intended such a type of NOCLAR to be covered through the reference to securities laws and regulations in the list of examples of laws and examples which the proposed standard would address.</p> <p>Point considered. The Task Force believes that insider trading at an institutional level (including where perpetrated by management) would be captured under the proposals. At a personal level, however, it would likely not as fines would not be levied at the corporate level. While individuals convicted of insider trading may face significant personal consequences, this would not necessarily result in a significant adverse impact on the entity, reputational or otherwise.</p>
<p>11. Ms. Miller noted that she had an opposite concern in that the scope appeared very broad, particularly given the reference in the draft text to “laws and regulations compliance with which may be fundamental to the operating aspects of the client’s business.” She highlighted the risk of reporting a matter that would turn out not to be actual non-compliance.</p>	<p>Ms. Gardner noted that the challenge for the IESBA had been to find the right balance. The Task Force had endeavored to make clear that the auditor is not being asked to search for NOCLAR but rather to respond <i>upon becoming aware</i> of information suggesting an instance of NOCLAR or suspected NOCLAR. In addition, she noted that the proposed standard explains that while the auditor is expected to apply knowledge, judgment and expertise to the matter, the auditor is not expected to have detailed knowledge of laws and regulations beyond that which is required for the audit.</p>
<p>12. Mr. James noted that narrowing the scope to</p>	<p>Point agreed.</p>

Matters Raised	Task Force/IESBA Response
address Ms. Miller's concern would create a bigger issue given that the scope is the same as that of ISA 250. Mr. Thompson agreed.	
13. Ms. de Beer noted that she found the list of examples of laws and regulations the proposed standard addresses helpful. She suggested that it be made clear that this list is not intended to be exhaustive.	Point not accepted. This is consistent with the current drafting conventions. In addition, if this change were made, it would have to be repeated everywhere else in the Code where lists of examples are provided.
14. Mr. Arteagoitia noted that the EC was supportive of the project. He commented that the proposed standard seemed to be addressing only matters affecting the entity but not consequences beyond the entity.	Support noted. Paragraphs 225.4 and 225.7 make clear that the proposed provisions address consequences of NOCLAR that go beyond the entity.
DETERMINING WHETHER TO DISCLOSE THE MATTER TO AN APPROPRIATE AUTHORITY	
15. Ms. de Beer was of the view that it would not be sufficient to simply acknowledge that in some jurisdictions there is legal or regulatory requirement to report NOCLAR or suspected NOCLAR to an appropriate authority. She was of the view that where there is such a duty to report, the PA must comply with it. Mr. Hansen agreed and suggested that this be included in the list of factors in paragraph 225.28 even if doing so would be repetitive. Mss. Robert and Singh agreed with Ms. de Beer and Mr. Hansen.	Point considered. The Task Force believes that the duty of the PA to comply with applicable laws and regulations is already clearly set out in paragraph 225.20(a). The PA would already need to have complied with this requirement before reaching the point of determining whether or not to make a disclosure to an appropriate authority. The Task Force noted that this duty is also already specified in paragraph 225.10. The Task Force believes that repeating the requirement a third time would be unnecessary.
16. Mr. Hansen also suggested that the reference to the client's "license" to operate in the first sub-bullet should be amended to the client's "ability" to operate.	Point accepted.
17. Mr. Bradbury wondered whether the reference to the client's license to operate could act as a disincentive for the auditor to report. He suggested that the Task Force consider strengthening the wording.	Ms. Gardner agreed that it should be the matter that should create a threat to the client's ability to operate and not the disclosure itself. Point considered. The Task Force noted that the reference in paragraph 225.28 is with respect to the matter and not to the disclosure.

Matters Raised	Task Force/IESBA Response
18. Ms. Lopez suggested adding “whether the public interest would be better served by disclosing the matter to an appropriate authority” to the list of factors affecting the PA’s decision as to whether to make such a disclosure.	Point not accepted. The Task Force noted that consideration of the public interest is already embedded in paragraph 225.21 through the determination of further action needed to achieve the objectives under the section. It is also in paragraph 225.26 regarding application of the third party test.
19. Mr. Greene wondered what would happen if the PA decided not to disclose.	Ms. Gardner noted that the requirement was for the PA to determine the nature and extent of further action needed. In addition, the PA would be required to document the PA’s thinking process, including the application of the third party test.
20. Ms. Lang expressed support for the list of factors in paragraph 225.28. However, she suggested consideration of better sign-posting given that at the point of considering whether or not to disclose the matter to an appropriate authority, the PA would have gone through many steps in the process.	Point not accepted. The Task Force believes that this could render this part of the proposed standard very granular. Doing so could also lead readers to perceive underlying rules about actions to take in particular circumstances, which is not the intention of the guidance.
21. Ms. McGeachy noted that the proposed standard had come a long way. She suggested that there be a link back in paragraph 225.28 to credible evidence of substantial harm to stakeholders.	Point not accepted. The Task Force believes that this would be unnecessary given that the reference to credible evidence of substantial harm is already included among the factors to consider in paragraph 225.22 re determination of further action needed.
22. Mr. Fukushima noted that at the September 2014 CAG meeting, he had expressed a concern about using the public interest as the threshold for disclosure to an appropriate authority, given the difficulty in ensuring consistent evaluation of that threshold. He expressed support for the revised approach to the threshold.	Support noted.
OTHER COMMENTS ON PROPOSED SECTION 225	
23. In the context of an audit engagement, Mr. Hansen wondered whether every member of the engagement team was intended to have	Point not accepted. The Code’s current drafting convention is to refer to a professional accountant in public practice, which it defines to also mean a

Matters Raised	Task Force/IESBA Response
<p>the same responsibility to deal with NOCLAR or suspected NOCLAR. In particular, he felt that it would be challenging for an intern or a junior member of the engagement team to raise the matter directly with management.</p>	<p>firm. To assign specific responsibility within an engagement team would introduce undue complexity. Rather, it is more likely that this matter of process would be addressed by quality control standards such as ISA 220,⁶ in particular with respect to engagement performance, direction, supervision and review.</p>
<p>24. With respect to raising the matter with the appropriate level of management, Mr. Hansen noted that there had been a discussion on this process aspect in the IAASB CAG earlier in the week in the context of the IAASB's work stream on ISA 600.⁷ Accordingly, he suggested that there would be an opportunity for the IESBA to liaise with the IAASB in this regard.</p>	<p>Point taken into account.</p> <p>The IESBA Task Force has been liaising with the IESBA Task Force with respect to addressing communication in the context of group audits.</p>
<p>25. In relation to PAs in public practice other than auditors, Mr. Hansen noted that it should not be assumed that they may not come across instances of fraud in carrying out their work. He highlighted for example that PAs providing tax services may become aware of tax fraud committed or being committed by their clients.</p>	<p>Point taken into account.</p> <p>The scope is the same across all categories of PAs. See paragraph 225.6.</p>
<p>26. Mr. Ayoub commented that the wording of the last sentence of paragraph 225.14 gave the impression that the PA would decide whether or not to seek legal advice. He felt that if the matter is a NOCLAR or suspected NOCLAR, the PA should consult legal counsel when appropriate and not make legal judgments which the PA may not be qualified to do.</p>	<p>Ms. Gardner noted that different stakeholders have different perspectives on the level of prescription needed. She noted that often the issue can be resolved through discussion with management.</p> <p>Point not accepted. The Task Force noted that nowhere in the Code is the PA obliged to take legal advice.</p>
<p>27. Mr. Ayoub also noted that if a NOCLAR or suspected NOCLAR were to be identified, this may lead to going concern issues for the entity. Accordingly, he suggested the addition of a reference to professional obligations as the PA may find it helpful to bear these in mind in such circumstances.</p>	<p>Point taken into account. This was already addressed in paragraph 225.20(b).</p>

⁶ ISA 220, *Quality Control for an Audit of Financial Statements*

⁷ ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

Matters Raised	Task Force/IESBA Response
<p>28. With respect to communication of the matter across a network for PAs in public practice other than auditors, Ms. de Beer felt that the wording of the proposed provision would leave too much to judgment. Mr. James agreed, noting that there should be the same requirement to communicate across the network as within the firm.</p>	<p>Ms. Gardner noted that the Task Force had discussed this issue at length and that there are a number of complexities that the PA would need to take into account in determining whether to make the communication.</p> <p>Point considered but not accepted for the reasons outlined in the explanatory memorandum to the re-ED.</p>
<p>29. Mr. Baumann noted that the draft standard had come a long way and that it was going in the right direction. He commented that the approach to escalation of the matter in a group audit context seemed weak. He was of the view that there should be a stronger emphasis that in any circumstances in which a component auditor identifies a NOCLAR or suspected NOCLAR that is deemed important, the matter should be elevated to the group engagement team. He noted that while a matter may be inconsequential at the component level, it may not be so at the group level.</p>	<p>Ms. Gardner noted that the proposed standard already would require the auditor to comply with professional standards, including communication with the group engagement team in the case of a group audit. Nevertheless, she added that the Task Force would further reflect on the matter.</p> <p>Point taken into account. The revised NOCLAR text post-exposure addresses this issue comprehensively (see discussion under “Communication with Respect to Group Audits” further below).</p>
<p>30. Mr. Dalkin noted that there had been significant improvement in the proposed standard and that it had matured. With respect to communication with TCWG, he noted that this is not commonplace in the public sector. Accordingly, he suggested that there be special considerations for public sector auditors in this regard.</p>	<p>Point considered.</p> <p>The Task Force noted that this matter concerns the broader Code and there would be benefit in the IESBA considering the matter separately as part of a dialogue with INTOSAI.</p>
<p>31. In relation to the documentation requirement, Mr. Fukushima noted that ISAs are focused on obtaining sufficient appropriate audit evidence. He was of the view that certain significant judgments that auditors may make under the proposed NOCLAR standard may be outside the scope of the documentation requirement as specified under the ISAs, and therefore not documented. He suggested that the Task Force reflect on this matter.</p>	<p>Point accepted. The Task Force included a specific reference to judgments made in the documentation requirement in paragraph 225.33.</p>

Matters Raised	Task Force/IESBA Response
PROPOSED SECTION 360	
32. Mr. Michel commented that the proposed standard would be a good step forward for PAs in business (PAIBs) as there has been little communication regarding the importance of ethics to that constituency. He suggested that the IESBA obtain PAIBs' feedback on the proposals.	Ms. Gardner agreed, noting that the IESBA had received input from PAIBs at the three global NOCLAR roundtables in 2014. In addition, the Task Force consulted with the IFAC PAIB Committee at its March 2015 meeting.
33. Ms. de Beer expressed support for the proposed Section 360. She noted that the challenge with respect to PAIBs is implementation and enforcement. She suggested that this may be a matter for the IFAC Compliance Advisory Panel to consider, perhaps through incorporating such considerations in the IFAC Statements of Membership Obligations (SMOs).	Point noted. The SMOs already address investigation and discipline.
34. Mr. James noted that PAIBs may have legal or regulatory responsibilities to report instances of NOCLAR or suspected NOCLAR that are not significant. He wondered whether there was a way to ensure that they are not discouraged from reporting what they are required by law or regulation to report.	Point considered. The Task Force noted that this matter is already addressed in paragraph 360.10.
35. He also wondered whether under the proposed standard, a PAIB who is a supervisor would be prompted to take appropriate action if the PAIB were to be informed of the matter indirectly as opposed to the PAIB himself or herself coming across it.	Point considered. The Task Force believes that the responsibilities would flow through to the supervisor if the matter were to come to the supervisor's attention through another employee within the organization.
36. Ms. Miller noted that many PAIBs are internal auditors and they may often come across NOCLAR or suspected NOCLAR at suppliers. She wondered whether the scope is really limited to matters identified at the PAIBs' employing organizations or whether this would be left to the PAIBs' judgment.	Point taken into account. NOCLARs that are not committed by the employing organization or by those charged with governance, management or employees of the employing organization are out of scope.
37. Mr. Dalkin commented that the framework	Point accepted.

Matters Raised	Task Force/IESBA Response
schematic was helpful. However, he suggested clarifying it to avoid implying that PAIBs would be required to raise a NOCLAR or suspected NOCLAR to their superior and TCWG at the same time.	Framework schematic adjusted accordingly.
38. With respect to ethics hotlines within government agencies, he noted that allegations that are without merit are a common occurrence. He suggested that there be appropriate considerations in that regard.	Point considered. The Task Force believes that this matter is outside the scope of this project.
39. Mr. Muis noted that legal immunity in a governmental context now often extends to individuals who are not political appointees, for example, treasurers. He wondered how this broadening of legal immunity could be justified.	Point noted. This matter is beyond the scope of this project.
40. Ms. Robert suggested clarification of the subheadings to make clear which provisions apply to senior PAIBs. She noted, for example, that paragraphs 360.12-13 refer to senior PAIBs but not paragraph 360.14.	Point accepted. Signposting added in paragraph 360.13.
RE-EXPOSURE	
41. Mr. Kockvedgaard inquired as to whether Representatives would support the IESBA issuing the proposed standard for re-exposure, subject to consideration of the CAG's comments. Messrs. Ayoub, Baumann, Bradbury, Dalkin, Hansen, and Michel, and Mss. Borgerth, de Beer, Elliott, Lopez, McGeachy, Miller, Robert and Singh indicated their support.	Support noted.
42. Mr. Muis noted that the IESBA is a global body and that it is facing many legislators that are unethical. He was of the view that it is challenging to set ethical standards without considering the ethical fabric of laws and regulations. Accordingly, he felt that the rationale for the proposed framework would be important and that the IESBA should maintain	Ms. Gardner noted that the IESBA was indeed doing so through the proposed standard and, in particular, through providing a pathway to disclosure where not already required by law or regulation.

Matters Raised	Task Force/IESBA Response
pressure on addressing NOCLAR issues at a global level.	
43. Ms. de Beer suggested that the wording of the draft rationale for the framework be reconsidered to avoid it sounding overly defensive in terms of protection of the profession from liability as opposed to the need to acknowledge the realities of the legal and regulatory framework and context.	Point accepted and reflected in the explanatory memorandum to the re-ED.
WAY FORWARD	
44. Ms. Gardner thanked Representatives for their constructive input, noting that their comments would be duly considered by the Task Force and the IESBA. As the project was not expected to be on the September 2015 CAG agenda given the timing of the re-ED, Mr. Waldron noted that it would be helpful for a progress report to be provided to the CAG in due course.	–

September 2015 Update to CAG

Below are extracts from the draft minutes of the March 2015 CAG meeting,⁸ and an indication of how the Task Force has responded to CAG Representatives' comments

Matters Raised	Task Force/IESBA Response
1. Ms. Gardner gave a preliminary update on responses to the May 2015 Exposure Draft, <i>Responding to Non-Compliance with Laws and Regulations</i> . Among other matters, she summarized the progress achieved on the project since the issuance of the first Exposure Draft in August 2012. She also highlighted the main themes from the responses, and selected key concerns from respondents, to the second Exposure Draft. Finally, she outlined the next steps and forward timeline for the project. Representatives noted the update.	–

⁸ The minutes were approved at the September 2015 IESBA CAG meeting.

Matters Raised	Task Force/IESBA Response
<p>2. Mr. Ahmed wondered about two general matters, namely (a) whether the Code is too prescriptive; and (b) where to draw the line in terms of which issues the Code should address and which issues it should leave to law or regulation.</p>	<p>Regarding point (a), the Task Force notes that the Code is founded on the basis of principles. However, in some areas such as NOCLAR and independence, it is necessary to specify a number of requirements (such as those laying out certain process steps) to guide the PA through a structured thought process or in appropriately responding to a particular issue or matter. These requirements do not in and of themselves make the Code prescriptive – the exercise of professional judgment will be paramount.</p> <p>Regarding point (b), the Task Force noted that the Code does not attempt to address matters that are within the purview of law or regulation. However, on a topic such as NOCLAR, a number of ethical considerations arise which do fall within the purview of the Code, for example, the public's expectation of a response by the PA to a NOCLAR matter given the PA's obligation to comply with the fundamental principles of integrity and professional behavior; and the need to assist the PA in meeting the PA's responsibility to act in the public interest.</p>

Update on Most Recent IESBA Discussion

13. At its November/December 2015 meeting, the IESBA broadly supported the Task Force's proposals in response to the significant ED comments on the various elements of the proposed NOCLAR response framework. In particular, the IESBA tentatively agreed to the following with respect to Section 225 (with corresponding changes to Section 360 where applicable):
- To adjust the wording of the third objective to: "To take such further action as appropriate in the public interest" (paragraph 225.4(c)); and the wording of the requirement to determine the need for further action to: "to determine if further action is needed *in the public interest*" (paragraph 225.24)⁹ This was to address a perceived circularity between this objective and the proposed ED requirement to determine if further action is needed to achieve the objectives under the section. Consequential changes have been made to the documentation provisions (last bullets of paragraphs 225.37 and 225.52).
 - To move the provision regarding the obligation of PAs to comply with applicable laws and regulations upfront, including recognition of the need to comply with any applicable legal or regulatory reporting requirement (paragraph 225.3). The provision now also duly acknowledges the fact that there may be laws and regulations that may be more stringent

⁹ Paragraph numbers in this section of the paper refer to Agenda Item J1-A1 (mark-up from December 2015 draft) unless otherwise stated.

than the Code with respect to responding to NOCLAR, and that laws and regulations may prohibit “tipping off” the client.

- Not to include guidance similar to that contained in the International Standards on Auditing (ISAs) regarding emphasizing the inherent limitations regarding auditors’ ability to detect NOCLAR, as the objectives of the proposals are very different from the objectives of the ISAs.
 - To refine the description of NOCLAR to cover acts committed by parties (other than employees) who work for, or under the direction of, the organization, such as non-executive directors and agents (paragraph 225.2).
 - To clarify that forensic-type engagements are out of scope insofar as the provisions regarding disclosure to an appropriate authority are concerned (paragraph 225.49).
 - To retain the differential approach to responding to NOCLAR for different categories of PAs, and in particular: not to differentiate on the basis of PAs’ “expected level of understanding” of laws and regulations; not to exempt (a) PAs in public practice other than auditors, and (b) PAs in business (PAIBs) other than senior PAIBs from responding to NOCLAR or suspected NOCLAR on the argument that their access to information is constrained; and not subjecting PAs in public practice other than auditors to the same response framework as auditors.
 - To retain the third party test (paragraph 225.27) regarding the determination of the need for, and the nature and extent of, further action. In particular, the IESBA agreed that this 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.
 - With respect to auditors in particular, to retain the balanced approach regarding determining whether or not to disclose an instance of NOCLAR or suspected NOCLAR to an appropriate authority (paragraphs 225.24-28 and 225.33-34). For the reasons set out in the explanatory memorandum (EM) to the ED, the IESBA reaffirmed that this approach is robust in that it establishes a responsibility on the auditor to objectively determine, as a possible course of further action, whether disclosure would be called for in the circumstances, consistent with the auditor’s responsibility to act in the public interest. The proposal, however, does not mandate disclosure, recognizing that such an approach would not be operable globally for the reasons outlined in the EM.
 - To give greater prominence to the statement that disclosure would be precluded if doing so would be contrary to law or regulation (paragraph 225.32).
 - On balance, retaining the approach to documentation.
14. At its November/December meeting, the IESBA also was briefed on the response from IOSCO Committee 1 (Committee 1) to the re-ED which was received after the close of the comment period. The IESBA considered preliminary Task Force reactions to the significant matters raised by Committee 1 and provided directional feedback to the Task Force.
15. Based on the IESBA discussion and editorial comments received from some IESBA members offline, the Task Force has refined the draft Sections 225 and 360 as shown in Agenda Item J1-A1. The Task Force’s responses to the significant matters raised by Committee 1 are set out in the

“Matters for Consideration” section below. Changes to the text have generally been made first to proposed Section 225, with corresponding changes to proposed Section 360 where appropriate.

Matters for Consideration

A. DISCLOSING NOCLAR TO AN APPROPRIATE AUTHORITY WITHOUT FOLLOWING SPECIFIED RESPONSE PROCESS

16. In its comment letter, Committee 1 raised the matter of whether PAs would be free to take relief from the duty of confidentiality under the Code and legitimately report an instance of NOCLAR to an appropriate authority without completing the response process set out in the Code.
17. During the IESBA discussion, some IESBA members noted the importance of following due process given that there can be differences of views regarding the significance of a particular NOCLAR matter. Other IESBA members, however, expressed support for allowing PAs not to be constrained by process in serious and exceptional circumstances where adhering to the specified process would in fact lead to an outcome that would not be in the public interest. It was felt that such “exemption” from following the process should be permissible where, in the PA’s judgment, the breach of a law or regulation is imminent and such a breach could have far-reaching consequences for stakeholders. In those circumstances, it was argued that the Code should not preclude an immediate response from the PA in terms of disclosing the matter directly to an appropriate authority. The IESBA supported addressing the issue on those grounds.
18. In the light of this discussion, the Task Force has developed proposed guidance on the matter as follows with respect to PAs performing audits of financial statements (see paragraph 225.35):

Where the professional accountant becomes aware of actual or intended conduct that the professional accountant has reason to believe would constitute an imminent breach of a law or regulation that would cause substantial harm to investors, creditors, employees or the general public, the professional accountant may exercise professional judgment and immediately disclose the matter to an appropriate authority. Such disclosure will not be considered a breach of the duty of confidentiality under Section 140 of this Code.

19. The proposed guidance makes it clear that the PA must have *reason to believe* that the matter would constitute an imminent breach of a law or regulation that would cause substantial harm to stakeholders. The “reason to believe” threshold addresses concerns at the IESBA that the Code should not provide an unfettered right for the PA to disclose NOCLAR or suspected NOCLAR to an appropriate authority without a proper understanding of the issue.
20. The Task Force believes that a similar provision should be available to PAs in public practice other than auditors, and senior PAIBs (see paragraphs 225.51 and 360.30). The Task Force did not believe that PAIBs other than senior PAIBs should be expected to take such action. This is not only because these other PAIBs have more limited access to information, but also because their response in such circumstances should reasonably be to immediately escalate the matter to their superior, consistent with the response framework.

Matter for CAG Consideration

1. Do Representatives agree with the Task Force’s proposals?

B. SCOPE

21. Paragraph 225.5 in the ED described the scope of laws and regulations covered by Section 225 as encompassing:
- (a) Laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the client's financial statements; and
 - (b) Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the client's financial statements, but compliance with which may be fundamental to the operating aspects of the client's business, to its ability to continue its business, or to avoid material penalties.
22. Committee 1 commented that the proposed section appeared to indicate that NOCLAR matters that are "material" or "fundamental" in nature are the starting point for the scope of the section. Accordingly, it wondered about the purpose of paragraph 225.8 in the ED which scoped out matters that are "clearly inconsequential." Committee 1 therefore suggested that the IESBA re-examine the interactions of the scoping distinctions.
23. The Task Force noted that paragraph 225.5 specifies the *types of laws and regulations* that are covered by Section 225. The starting point of the section is therefore not acts of non-compliance that are of a material or fundamental nature. Indeed, part of the response framework is focused on directing the PA to obtain an understanding of the matter, including the nature of the matter and its potential consequences. Some matters that the PA may encounter or be informed about might be clearly inconsequential. The section therefore scopes out such matters.
24. To make this clearer, the Task Force proposes to make the following changes to Section 225:
- (a) Rewording the lead-in to paragraph 225.5 to state that the section "sets out the approach to be taken by a professional accountant who comes across or is made aware of non-compliance or suspected non-compliance with" laws and regulations in the categories of laws and regulations described in subparagraphs 225.5(a) and (b);
 - (b) Moving to a separate paragraph the statement that a PA who comes across or is made aware of matters that are clearly inconsequential is not required to comply with the section (see paragraph 225.8); and
 - (c) Deleting the original scope-out provision regarding clearly inconsequential matters (see marked-up paragraph 225.9).

Matter for CAG Consideration

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

C. COMMUNICATION WITH RESPECT TO GROUP AUDITS

25. In its response, Committee 1 suggested that the Code should clearly articulate that the lead audit engagement team should be notified in all cases when an act of NOCLAR arises in any jurisdiction during the performance of an audit or a non-audit service (NAS) at a component. Committee 1 also suggested that it would be helpful to enhance the focus on the difficulties arising for auditors when faced with a group audit situation, whether all of the auditors involved belong to the same network or not.

26. Related, in its discussions, the IAASB NOCLAR Task Force has sought clarification regarding whether the IESBA intends its proposals regarding communication with respect to group audits to apply to:
- (a) All components in a group, including those for which work other than an audit is undertaken by the auditors of the components for group audit purposes (for example, a review or agreed-upon procedures); and
 - (b) An act of NOCLAR or suspected NOCLAR identified by the auditor of a component in the course of an audit that is not undertaken for group audit purposes (for example, a statutory audit of a component's financial information).
27. The Task Force believes that the Code should address both of the above for the following two reasons:
- The non-compliance may have significant implications for the group as a whole (irrespective of the size of the component), whether in terms of the integrity of management or those charged with governance (TCWG) where the matter is pervasive to the group, or in terms of the potential adverse impact on the financial statements of the group.
 - It is possible that other components may be implicated, for example, in money laundering and other non-compliance that could involve other parties within the group as counter-parties.
28. Accordingly, the Task Force proposes that paragraph 225.20 be amended to read:

Where the professional accountant is the auditor of a component of a group, the professional accountant may be requested by the group engagement team to perform an audit of the component's financial information for group audit purposes. The professional accountant may also be engaged by the component to perform an audit of the component's financial information for purposes other than the group audit, for example, a statutory audit. Where the professional accountant becomes aware of non-compliance or suspected non-compliance in relation to the component in either situation, the professional accountant shall, in addition to responding to the matter in accordance with the provisions of this section, communicate it to the group engagement partner unless prohibited from doing so by law or regulation. This is to enable the group engagement partner to be informed about the matter and to determine how it should be addressed in accordance with the provisions in this section.

29. Equally, to ensure that there is appropriate downstream communication from the group engagement team to the auditors of components where the matter is deemed relevant to the particular components, the Task Force proposes to add the following provision in paragraph 225.21:

Where the group engagement partner becomes aware of non-compliance or suspected non-compliance in the course of the audit of the parent entity in a group audit, or is informed of it by the auditor of a component in the group in relation to that component, the group engagement partner shall consider whether the matter is relevant to each component whose financial information is subject to an audit or other work for group audit purposes. If so, the group engagement partner shall take steps to have the matter communicated to the auditors of the relevant components, unless prohibited from doing so by law or regulation. This is to enable the audit engagement partners for the relevant components to be informed about the non-compliance or suspected non-compliance and to determine how it should be addressed in accordance with the provisions in this section.

30. Finally, the Task Force agreed to the point raised by Committee 1 regarding circumstances where the matter is identified during the provision of an NAS to a component in a group. The Task Force proposes that this be addressed in two separate respects:
- (a) The NAS is a non-audit service that is not provided for group audit purposes (for example, a consulting service); and
 - (b) The NAS is non-audit work performed on a component's financial information for group audit purposes (for example, a review or an audit of only certain account balances).
31. In the first case, the Task Force proposes that paragraph 225.43 be amended as follows to scope in a component of an audit client of the firm or a network firm:

If the professional accountant is performing a non-audit service for an audit client, or a component of an audit client, of the firm or a network firm, the professional accountant shall consider whether to communicate the ~~matter~~ non-compliance or suspected non-compliance within the firm or to the network firm (including the network firm responsible for the group audit engagement as applicable) in accordance with the firm's or the network's protocols or procedures, ~~or, in the absence of such protocols and procedures, the professional accountant shall consider whether to communicate the matter directly to~~ the audit engagement partner or group engagement partner, as applicable. If the client is not an audit client, or a component of an audit client, of the firm or a network firm, the professional accountant shall consider whether to communicate the matter to the firm that is the external auditor, if any. In all cases, the communication is to enable the engagement partner for the audit or the group engagement partner, as applicable, to be informed about the matter and to determine how it should be addressed in accordance with the provisions of this section.

This makes the communication subject to consideration of the factors set out in paragraph 225.44.

32. In the second case, the Task Force proposes that the PA be required to bring the matter to the attention of the group engagement partner as the NAS is being performed specifically for group audit purposes (paragraph 225.45):

For purposes of a group audit engagement, the professional accountant may be requested by the group engagement team to perform work on a component's financial information that is not an audit of that component's financial information (for example, a review, an audit of only certain account balances, classes of transactions or disclosures, or specified audit procedures). Where the professional accountant becomes aware of non-compliance or suspected non-compliance in relation to the component in such a situation, the professional accountant shall communicate the matter to the group engagement partner unless prohibited from doing so by law or regulation. This is to enable the group engagement partner to be informed about the matter and to determine how it should be addressed in accordance with the provisions in this section.

33. The Task Force has made a corresponding refinement to the last bullet of paragraph 225.44 to read:

The likely materiality of the matter to the audit of the client's financial statements or, where the matter relates to a component of a group, its likely materiality to the audit of the group financial statements.

Matter for CAG Consideration

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

D. DOCUMENTATION BY PAS OTHER THAN AUDITORS

34. Committee 1 suggested that it would be prudent for PAs who are not auditors to have as strong a provision to document appropriate NOCLAR matters as auditors. It was of the view that a significant NOCLAR matter could be subject to legal proceedings and therefore a well-documented account of the matter could help establish the key decisions and positions taken by the PA.
35. The Task Force noted that the IESBA had considered at length whether to impose documentation requirements on PAs other than auditors, a position that was taken in the first Exposure Draft. The IESBA noted that many respondents then were opposed to this proposal. This was not only because of concerns that the resulting documentation could be legally discoverable but also because of concerns that such an approach would diverge from the Code's current position of generally advocating documentation in the PA's interests but not requiring it.
36. Having reflected on the matter further, the Task Force is recommending that the IESBA continue to retain a differential approach to documentation, i.e., a documentation requirement for auditors commensurate with the higher public expectations of their role, and an encouragement for other PAs. Such an approach would ensure a more proportionate treatment by avoiding an unreasonable burden on these other PAs, recognizing their different roles compared with auditors. This would also be more consistent with one of the key aims of the project, which is to provide guidance to PAs in responding to NOCLAR.

Matter for CAG Consideration

4. Do Representatives agree with the Task Force's response?

E. COMMUNICATION BETWEEN EXISTING AND PROPOSED AUDITORS

37. Regarding circumstances where there is a change of auditors as a result of a NOCLAR matter, Committee 1 expressed a concern that instead of requiring the existing auditor to communicate the matter to the proposed auditor, paragraphs 210.11¹⁰ and 210.13¹¹ in the ED allowed confidentiality to be used as a reason to restrict the communication of such a matter between the existing and proposed auditors. Committee 1 argued that confidentiality should not be a mechanism to restrict the existing auditor's public-interest obligation to inform a proposed auditor of known facts and circumstances concerning a NOCLAR. Committee 1 further expressed the view that prior to the existing auditor discussing the matter with the proposed auditor, it would be appropriate for the

¹⁰ Paragraph 210.11 in the ED stated the following: "An existing accountant is bound by confidentiality. Whether that professional accountant is permitted or required to discuss the affairs of a client with a proposed accountant will depend on the nature of the engagement and on: (a) whether the client's permission to do so has been obtained; or (b) the legal or ethical requirements relating to such communications and disclosure, which may vary by jurisdiction."

¹¹ Paragraph 210.13 in the ED stated the following: "In the case of an audit of financial statements, a professional accountant shall request the existing accountant to provide known information regarding any facts or circumstances that, in the existing accountant's opinion, the proposed accountant needs to be aware of before deciding whether to accept the engagement. If the client consents to the existing accountant disclosing any such facts or circumstances to the proposed accountant, the existing accountant shall provide the information honestly and unambiguously. If the client fails or refuses to grant the existing accountant permission to discuss the client's affairs with the proposed accountant, the existing accountant shall disclose this fact to the proposed accountant, who shall carefully consider such failure or refusal when determining whether or not to accept the appointment."

existing auditor to inform the client of the intention to discuss the matter rather than needing the client's permission to do so.

38. During the December IESBA discussion, there was a concern about removing client consent from Section 210¹² as a precondition to the communication between the existing and proposed auditors. It was felt that this could lead to the communication of matters unrelated to NOCLAR. In particular, unlike in NOCLAR circumstances, the Code would provide no criteria for overriding confidentiality in those other situations. It was therefore argued that removing consent in such a way would extend beyond what the IESBA had originally intended in relation to NOCLAR. On the other hand, there was also a view that it would be important for the proposed auditor to clearly understand the circumstances surrounding the change of appointment. It was therefore felt that it may not be appropriate to limit the exception to client consent to NOCLAR situations only. It was noted, for example, that if the existing auditor disagrees with management on a particular accounting treatment, management could simply justify the change in auditors on “good governance grounds” rather than provide the real reasons.
39. It was also noted during the IESBA discussion that in practice, consent generally comes with a “hold harmless” commitment from the client. Accordingly, if the communication requirement is to be effective, it should come with some protection for the existing auditor. It was noted, however, that if such protection cannot be guaranteed, it may be appropriate to seek client consent. It was noted also that in any event, if consent is not obtained this would be a “red flag” for the proposed auditor.
40. In the light of this discussion, the Task Force proposes to retain the general requirement to obtain client consent but to allow an exception regarding communication of relevant information to the proposed auditor in the case of NOCLAR even if such consent is not obtained (see paragraphs 210.13 and 225.30).
41. In its response, Committee 1 also commented that the ED was silent regarding circumstances where the existing auditor does not, or refuses to, provide information regarding any facts or circumstances concerning the NOCLAR matter, even after having obtained the client's consent. Committee 1 therefore suggested that the Code should provide guidance regarding such situations.
42. The Task Force noted that extant paragraph 210.12 already requires that, if the proposed accountant is unable to communicate with the existing accountant (despite the latter having obtained client consent), the proposed accountant take reasonable steps to obtain information about any possible threats by other means. Such means include inquiries of third parties or background investigations of senior management or TCWG. Acknowledging Committee 1's concern, the Task Force proposes that a similar provision be added to paragraph 225.30.

Matter for CAG Consideration

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

Material Presented – IESBA CAG Papers

Agenda Item J1-A1 Revised NOCLAR Text (Mark-Up from December 2015 Draft)

Agenda Item J1-A2 Revised NOCLAR Text (Mark-Up from re-ED)

¹² Extant Section 210, *Professional Appointment*

Agenda Item J1-A3 Revised NOCLAR Text (Clean)

Appendix

Project History

Project: Responding to Non-Compliance or Suspected Non-Compliance with Laws and Regulations

Summary

	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 2012 – December 2012	
Consideration of respondents' comments on exposure and development of revised proposals	April 2013 September 2013	March 2013 June 2013 September 2013 December 2013
Consideration of tentative revised proposals	March 2014	–
Updates regarding NOCLAR roundtables	–	April 2014 July 2014
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

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

CAG Discussions: Detailed References

Project Commencement	<p><u>March 2010</u></p> <p>See IESBA CAG meeting material here and CAG meeting minutes (section C).</p> <p><u>September 2010</u></p> <p>See IESBA CAG meeting material and CAG meeting minutes (section C).</p>
Development of Proposed International Pronouncement (Up to Exposure)	<p><u>March 2011</u></p> <p>See IESBA CAG meeting material and CAG meeting minutes (section D).</p> <p><u>September 2011</u></p> <p>See IESBA CAG meeting material and CAG meeting minutes (section C).</p> <p><u>March 2012</u></p> <p>See IESBA CAG meeting material and CAG meeting minutes (section D).</p>
Consideration of Respondents' Comments and Development of Revised Proposals	<p><u>April 2013</u></p> <p>See IESBA CAG meeting material and CAG meeting minutes (section B).</p> <p>See report back on April 2013 discussion.</p> <p><u>September 2013</u></p> <p>See IESBA CAG meeting material and CAG meeting minutes (section F).</p> <p>See report back on September 2013 discussion.</p> <p><u>March 2014</u></p> <p>See IESBA CAG meeting material and CAG meeting minutes (section B).</p> <p>See report-back on March 2014 discussion.</p> <p><u>September 2014</u></p> <p>See IESBA CAG meeting material and CAG meeting minutes (section E).</p> <p>See report back on September 2014 discussion.</p> <p><u>March 2015</u></p> <p>See IESBA CAG meeting material and CAG meeting minutes (Section B).</p>

	See report back on March 2015 discussion in this agenda item.
Consideration of Respondents' Comments on Re-ED and Development of Final Proposals	<u>September 2015</u> See presentation slides . See report back on the brief September 2015 discussion in this agenda item.