

**Meeting:** IAASB  
**Meeting Location:** New York  
**Meeting Dates:** June 21–24, 2016

# Agenda Item 3

## Non-Compliance with Laws and Regulations (NOCLAR)

### Objectives of Agenda Item

1. To consider the remaining issues and the NOCLAR Task Force recommendations, as well as the proposed revisions to ISA 250 (Revised)<sup>1</sup> and the related conforming amendments.
2. To finalize and approve the standard for submission to the Public Interest Oversight Board.

### NOCLAR Task Force

3. The NOCLAR Task Force comprises:
  - Brendan Murtagh, Chair, IAASB Member
  - Chuck Landes, IAASB Deputy Chair
  - Richard Fleck, IESBA Deputy Chair
  - Marek Grabowski, IAASB Member
  - Inge Vanbeveren, IAASB Technical Advisor
  - Denise Weber, IAASB Technical Advisor

### Activities since the last IAASB Discussion

3. The NOCLAR Task Force has held two teleconferences since the last IAASB Discussion at the April teleconference.

### Material Presented

Agenda Item 3-A	NOCLAR Issues and Task Force Recommendations
Agenda Item 3-B	NOCLAR Proposed amendments to ISA 250 and conforming amendments (Marked from March 2016 meeting and April 2016 teleconference)
Agenda Item 3-C	NOCLAR Proposed amendments to ISA 250 and conforming amendments (Clean)
Agenda Item 3-D	NOCLAR Proposed amendments to ISA 250 and conforming amendments (Marked from Exposure Draft)

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

Agenda Item 3-E      NOCLAR Proposed amendments to ISA 250 and conforming amendments  
(Marked from extant)

**Action Requested**

4. Matters for IAASB consideration are set out in **Agenda Item 3-A**, as background to the proposed changes to ISA 250 and the related conforming amendments included in **Agenda Item 3-B**. **Agenda Item 3-D** has been presented to facilitate the IAASB's consideration of the need for re-exposure, showing marked changes from the Exposure Draft.

## Draft Summary of the IAASB's Discussions at its March 2016 Meeting

### Non-Compliance with Laws and Regulations

The Board received an update from Mr. Fleck, Deputy Chair of the International Ethics Standards Board for Accountants (IESBA) and Chair of the IESBA's project addressing NOCLAR, on the IESBA's recent discussions. Mr. Fleck emphasized that the IESBA had noted the importance of striking a balance between the broad spectrum of views from respondents and the importance of enhanced activities regarding NOCLAR to the reputation of the profession. Mr. Fleck indicated that the IESBA would closely monitor and revisit its NOCLAR changes in the future if it created an unintended result, or to respond to any changes made by the IAASB as a result of its projects, for example, the Group Audits project. Mr. Fleck informed the Board that the IESBA had closed off the NOCLAR draft and that IESBA would be asked to approve it at a teleconference on April 25, 2016, subject to the consideration of fatal flaw comments from the IAASB in the context of discussions on the feedback to the IAASB Exposure Draft (ED) and the way forward.

#### COMMENTS FROM THE IAASB ON THE IESBA NOCLAR PROPOSALS

Mr. Fleck outlined the significant changes to IESBA's NOCLAR proposals since the IAASB's December 2015 meeting, noting that these included new proposals regarding the communication of NOCLAR within a group audit, as well as new proposals addressing circumstances when there is a risk of an imminent breach of law and regulation.

The Board commented as follows:

- The requirement that the communication within the group should be "on a timely basis" raised concerns, since none of the other procedures in the *Code of Ethics for Professional Accountants* (IESBA Code) contain a similar reference and it was unclear what "on a timely basis" means. Mr. Fleck indicated that everything in the IESBA Code should be done on a timely basis and that the IESBA could consider a more generic clause dealing with this topic.
- Proposed paragraphs 225.20 and 225.21 in the IESBA Code (**Agenda Item 7-C**) seem to be misplaced as they do not accurately reflect the process that the professional accountant would follow before communicating the NOCLAR within the group. There was also a view that the requirements in these paragraphs would be difficult to apply in practice, particularly in large groups, as it may not be clear to those performing statutory audits of a component who the group auditor is if they are not performing work for the group engagement team. Mr. Fleck noted that the IESBA believes that the positioning of these paragraphs is appropriate, as reporting within the group should not be a last step in the process. He explained that actions by auditors at a component level to respond to the NOCLAR could be detrimental to how the matter is being handled overall at a group level, for example by tipping off management. Mr. Fleck emphasized that the expectation would be for auditors to consider what has been discovered and whether it could be more serious than it appears, and then report within the group. He noted that this would require taking the necessary steps to locate the other auditor to whom communication is necessary.
- Questions were raised regarding the wording that indicates that the purpose of the communication between the group auditor and other auditors is to determine "how" the NOCLAR should be addressed in terms of the IESBA Code, which does not provide sufficient flexibility for circumstances

where there is no further action required by the auditor within the group to whom the NOCLAR has been reported. Mr. Fleck was of the view that the statement regarding “how” the NOCLAR should be addressed does provide such flexibility.

- It was questioned, whether circumstances where a predecessor auditor is unwilling to communicate NOCLAR to a successor auditor (as indicated in paragraph 225.30 (**Agenda Item 7-C**)) would be considered a violation of the IESBA Code. One IAASB member interpreted this paragraph as requiring the predecessor auditor to locate the successor auditor, which creates an obligation that may be overly burdensome and impracticable in some circumstances, such as when a successor auditor is not appointed immediately. Mr. Fleck confirmed the view that a predecessor auditor who follows the IESBA Code has an obligation to disclose NOCLAR to a successor auditor, although he noted that the wording could be improved and that the practical difficulties of the implementation of this section could be dealt with in implementation guidance.
- There was also some concerns with the requirement in paragraph 225.35 (**Agenda Item 7-C**) to report intended breaches of laws and regulations, because it would require the professional account to perform an action prior to going through the full process otherwise required by IESBA's NOCLAR proposals. Mr. Fleck highlighted that these provisions address NOCLAR that could cause substantial harm to the public, and he did not believe that this was too onerous in light of the potential for substantial harm to the public.
- The applicability of the IESBA Code to professional accountants who encounter NOCLAR in the circumstances where the group is subject to a review engagement was questioned. Mr. Fleck highlighted the difficulty of drafting provisions addressing a wide variety of circumstances, such as review engagements of groups, and noted that this was addressed in the section of the NOCLAR proposals dealing with non-audit engagements.
- On behalf of Prof. Köhler, Mr. Böhm commented on the nature, extent and timing of co-operation between the IAASB and IESBA, and reiterating the belief that earlier and more in-depth co-operation should have occurred, as well as other matters raised in the IDW comment letter. Mr. Fleck indicated that the IESBA NOCLAR proposals are addressing a reputational issue associated with performing audits, which is unaffected by the nature or size of the entity. Prof. Schilder highlighted that IAASB and IESBA leadership recently met with IDW leadership to discuss this views. He explained that, although there could be improvements in the process in the future, in his view the IAASB and IESBA had coordinated early and continuously throughout the process.

#### PROPOSED LIMITED AMENDMENTS TO ISA 250<sup>2</sup> AND RELATED CONFORMING AMENDMENTS

The Board considered the significant issues raised by respondents to the IAASB's NOCLAR ED and the Task Force's recommendations thereon, as well as a revised draft of proposed ISA 250 and the related conforming amendments, as set out in **Agenda Items 7-A and 7-B**. Mr. Murtagh indicated that comments from the International Organization of Securities Commissions (IOSCO) and KPMG were inadvertently not included in **Agenda Item 7-A** but would be considered by the Task Force prior to the IAASB's June 2016 meeting and highlighted some of the key comments.

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

The Board agreed that, to the extent possible, the terminology in the ISAs and the IESBA Code should be aligned, unless deviating is necessary for the purposes of the ISAs. In addition to editorial and other minor comments, the Board commented as follows:

- A few members believed that the new construct of paragraph 28 of ISA 250 was confusing. It was noted that the CAG had similar concerns. Mr. Murtagh indicated that the Task Force would reflect on paragraph 28, and the related application material in paragraphs A19–A19b, including the reference to “misstatements”, since not all NOCLAR would result in a misstatement.
- A concern was expressed about the potential implications of aligning the definition of non-compliance with the IESBA NOCLAR proposals, noting that this could broaden the scope of ISA 250. Accordingly, it was agreed that the Task Force would investigate the history of the definition and consider the impact, if any, of the changes to the definition in ISA 250.
- One member questioned whether the ISAs should take the approach in the IESBA Code and not require the auditor to look for NOCLAR. Mr. Murtagh noted that paragraph 14 of extant ISA 250 requires the auditor to identify NOCLAR, because of the need to obtain sufficient appropriate audit evidence regarding compliance with those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements. He also noted that the Task Force would consider whether clarification of the wording in ISA 250 is needed.
- There was concern that the material referring to the communication of key audit matters could be misinterpreted, and that the benefits of discussing NOCLAR in the auditor’s report could be outweighed by negative consequences, particularly when the NOCLAR had been appropriately dealt with. Accordingly, it was suggested that a more generic discussion of the impact on the auditor’s report may be more appropriate.
- One member suggested that the application material in paragraph A15, regarding the appropriate level of management and, when appropriate, those charged with governance, be included in other standards and requested the Task Force to revisit the references to “management” and “those charged with governance” to ensure these are used consistently throughout ISA 250 and the conforming amendments.

#### OTHER MATTERS

A member also raised a concern about the interpretation of paragraph 14 and A14 of ISA 200<sup>3</sup> as discussed in **Agenda Item 7-B**, noting that there are many jurisdictions in Europe where the IESBA Code is not used and that a stricter interpretation of paragraph 14 and A14 of ISA 200 could have consequences for the adoption of the ISAs in the European Union. Prof. Schilder supported placing the topic on the agenda of the Steering Committee.

While a few members indicated their support for a more fulsome review of ISA 250, the IAASB agreed that such a review is not within the scope of this project, but should be considered as part of the next IAASB Work Plan.

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<sup>3</sup> ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

Mr. Gunn highlighted the proposed effective date of the IESBA Code, likely to be July 1, 2017 and asked the Board to consider what effective date would be appropriate for the NOCLAR provisions in the IAASB's International Standards. Prof. Schilder suggested that the Task Force consider the proposed effective date before the June 2016 meeting.

#### CAG CHAIRMAN'S REMARKS

Mr. Waldron noted that the joint IAASB and IESBA session on NOCLAR at the March 2016 CAG meeting was useful, as there was good engagement, a clear interest and helpful feedback on the proposals. He indicated that there was overall support for the IAASB's proposed changes to ISA 250 and the conforming amendments.

#### PIOB OBSERVER REMARKS

Mr. Van Hulle indicated that he noticed a number of divergences in wording between the IESBA Code and the IAASB's International Standards and supported the use of consistent terminology if there are no differences in substance. He also noted that the revisions to paragraph 28 could be seen as confusing, and also suggested the reference to financial institutions in the application material be re-considered, as communications with supervisors are often required.

#### WAY FORWARD

The Task Force will present a limited selection of issues to the IAASB's teleconference in April 2016, and will seek the Board's approval of the conforming amendments to the International Standards in June 2016.

## **Draft Summary of the IAASB's Discussions at its April 2016 Teleconference**

### **Non-Compliance with Laws and Regulations**

Mr. Murtagh indicated that the Task Force had considered the comments from the International Organization of Securities Commission (IOSCO) and KPMG and that the issues paper reflected comments from these two respondents that related to the items for discussion. Any remaining items from those responses will be incorporated into the June 2016 agenda material.

#### RESPONSIBILITY TO REPORT NON-COMPLIANCE TO AN APPROPRIATE AUTHORITY OUTSIDE THE ENTITY

Mr. Murtagh provided an overview of the key changes to paragraph 28 of ISA 250 and the related application material, which were proposed in response to the comments received from the Board and the CAG at their respective March 2016 meetings.

There was not full support from the IAASB regarding the revised wording explaining the auditor's responsibility to report NOCLAR. In particular, some members did not agree with the phrase "in relation to reporting", as it was not sufficiently clear. The Task Force was asked to consider how this requirement could differentiate that, in some cases, the auditor is only required to determine *whether* to report NOCLAR, and therefore does not have an explicit reporting requirement.

In addition, the majority of the Board did not agree with including the second sentence in paragraph 28, which dealt with the duty of confidentiality. It was seen to be confusing as well as duplicative of application material.

Two members did not agree with including a specific reference to the IESBA Code in paragraph A19d, on the basis that not all jurisdictions apply the IESBA Code, which could unduly call into question whether auditors in those jurisdictions are in compliance with the ISAs.

The Task Force was also asked to consider whether the ordering of the application material was consistent with how decisions regarding NOCLAR would normally be reached, with some concern expressed by the PIOB observer that the current sequencing could be viewed as not promoting disclosure of NOCLAR.

In summary, the Board requested that the drafting of paragraph 28 be reconsidered, noting the Board was satisfied with the direction of the Task Force, and that the second sentence in paragraph 28 would be removed. Furthermore, the organization of the application material would be reconsidered.

#### DEFINITION OF NON-COMPLIANCE

Mr. Murtagh noted that, in finalizing the IESBA NOCLAR pronouncement, the IESBA had removed the reference to “persons” in Section 225.9(b). Accordingly, Mr. Murtagh proposed that paragraph 11(b) of ISA 250 be aligned to the revised wording in the IESBA NOCLAR pronouncement as follows: “Non-compliance other than by the entity or those charged with governance, management or other individuals working for or under the direction of the entity”.

Many members were supportive of the revised wording proposed by Mr. Murtagh. However, some members questioned the necessity of having paragraph 11(b) in the definition, since the definition is already clear about what is considered to be non-compliance, and suggested that it could be relocated to the application material.

One member continued to express concern with the relocation of the sentence that deals with “transactions entered into by, or in the name of, the entity, or on its behalf, by those charged with governance, management or other individuals working for or under the direction of the entity” to the application material in paragraph A6. This member was concerned that not all stakeholders would agree that this text in extant ISA 250 is an illustration of non-compliance. There was also a request to provide clarity regarding personal misconduct related to the business activities of the entity that would be considered to be within the scope of ISA 250, through the use of an example.

#### EFFECTIVE DATE

The Board provisionally agreed that the revisions to the IAASB’s International Standards should become effective for audits of financial statements for periods beginning on or after December 15, 2017. It was noted that the effective date of the IESBA NOCLAR pronouncement applies to acts of non-compliance that come to the professional accountant’s attention on or after July 15, 2017.

#### OTHER MATTERS

Concern was raised about the additional requirements in the IESBA NOCLAR pronouncement to communicate NOCLAR in the circumstances of group audits. A few members were somewhat apprehensive about the IAASB’s decision at the March 2016 meeting to not make any revisions to ISA

600<sup>4</sup> to address NOCLAR at this time and instead include the issue in the IAASB's ongoing project in relation to ISA 600. These members were of the view that, because those revisions would only come into effect in several years' time, this would result in a temporary gap between the IESBA Code and the ISAs, which would be unhelpful. It was suggested that the Task Force could explore whether a new requirement could be included in ISA 250 (Revised) to alert auditors to the additional requirements in respect of group audits contained in the IESBA NOCLAR pronouncement, which could be deleted at a later stage when ISA 600 is revised. Mr. Murtagh noted that adopting an approach of making temporary revisions to the ISAs was not the usual practice and would need to be thoroughly considered by the IAASB before implementing these types of changes.

**PIOB Comments**

Mr. Holm supported the changes to the definition and the proposed effective date. However, Mr. Holm believed that paragraph 28 was not sufficiently clear about the requirement to report non-compliance and shared some suggested improvements. He further noted the sequencing of the application material supporting paragraph 28 should be revisited.

**Consultative Advisory Group Chair's Remarks**

Mr. Waldron agreed with the views of the majority of the Board that the second sentence of paragraph 28 should be removed.

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<sup>4</sup> ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*