

ICAP comments on Exposure Draft – Responding to Non Compliance with Laws and Regulations

General Matters

Question 1

Where law or regulation requires the reporting of identified or suspected non compliance with laws and regulations (NOCLAR) to an appropriate authority, do respondents believe the guidance in the proposals would support the implementation and application of the legal or regulatory requirement?

Answer 1

The guidance in the proposal supports the implementation and application of the legal or regulatory requirements. The approach to responding to identified or suspected NOCLAR is divided into four categories of professional accountants (PA), that is, auditors, senior PAIBs, PAs in public practice providing services other than audits and other PAIBs which provide ease in responding to suspected or identified NOCLAR as PAs may directly refer to their respective sections for guidance. Moreover, guidance on understanding the matter, addressing it to those charged with governance (TCWG), determining the further action and the concept of substantial harm for defining the threshold for further action are of significance in devising appropriate response to the NOCLAR.

Question 2

Where there is no legal or regulatory requirement to report identified or suspected NOCLAR to an appropriate authority, do respondents believe the proposals would be helpful in guiding PAs in fulfilling their responsibility to act in the public interest in the circumstances?

Answer 2

Where there is no legal or regulatory requirement to report identified or suspected NOCLAR to an appropriate authority, the proposed guidance is helpful as PAs have defined course of path to follow in identifying and responding to NOCLAR to appropriate authority.

Question 3

The Board invites comments from preparers (including TCWG), users of financial statements (including regulators and investors) and other respondents on the practical aspects of the proposals, particularly their impact on the relationships between:

- (a) Auditors and audited entities;
- (b) Other PAs in public practice and their clients; and
- (c) PAIBs and their employing organizations.

Answer 3

The proposal will impact relationships in following manner:

- (a) Auditors and audited entities:

Auditors are required to understand the matter and discuss it with TCWG. In case of disagreement, auditors will report the matter to an appropriate authority after considering threshold and further actions. The disclosure to appropriate authority will impair audit client relationship which may result into discontinuance of the audit service because such matters become matter of public interest which will defame market reputation of audit client.

- (b) Other PAs in public practice and their clients:

, Response to this point is same as point (a) above.

(c) PAIBs and their employing organizations:

In case of reporting of NOCLAR to an appropriate authority will endanger job security of PAIBs. This insecurity will prevent PAIBs from reporting NOCLAR. In such a circumstance, audit committee shall be strong enough to provide job security to such PAIBs, maintain an ethics based culture including policies and procedures to prevent non compliances with laws and regulations.

Specific Matters

Question 4

Do respondents agree with the proposed objectives for all categories of PAs?

Answer 4

The overriding principle of the proposal is that PAs have the responsibility to act in public interest. Three broad proposed objectives, that are, to ensure PAs do not close their eyes to identified or suspected NOCLAR and that they do not bring profession into disrepute, to alert management and TCWG to seek remedial actions to mitigate the consequences of the NOCLAR and to deter the commission of the NOCLAR where it has not yet occurred and finally to take further action in public interest. All these proposed objectives require PAs to act in accordance with fundamental principles of integrity and professional behavior and thus supports the overriding principle for all four categories of PAs.

Question 5

Do respondents agree with the scope of laws and regulations covered by the proposed Sections 225 and 360?

Answer 5

The scope of proposed sections of 225 and 360 addresses all such laws which directly impact the determination of material amounts and disclosures in financial statements and all other laws and regulations which may be fundamental to the operating aspects and going concern of the business. These fundamental principles in determining the laws and regulations which are scoped in, are very helpful as it reduces the chances of any NOCLAR from being unnoticed and timely reported.

Question 6

Do respondents agree with the differential approach among the four categories of PAs regarding responding to identified or suspected NOCLAR?

Answer 6

The approach for responding identified or suspected NOCLAR for auditors is very elaborative. Guidance on understanding the matter and addressing it with management and TCWG, determining the need for further course of action, the concept of "Substantial Harm", third party test at earlier stage which helps in determining the further course of action and determining the need to disclose the matter to an appropriate authority and who is the appropriate authority are explicit enough for an auditor to deal with a particular NOCLAR.

Approach for Senior PAIBs is similar to that of auditors except three noteworthy exceptions, that is, to take appropriate steps to rectify and minimize the consequences and reoccurrence of NOCLAR, to deter the NOCLAR if it has not yet occurred and to alert the external auditor of such NOCLAR, are satisfactory way of responding to identified or suspected NOCLAR.

For Other PAIBs, the approach to communicate the identified or suspected NOCLAR to immediate superior or next higher level in authority and the use of internal whistle blowing policy is appropriate way of responding the NOCLAR.

Question 7

With respect to auditors and senior PAIBs:

- (a) Do respondents agree with the factors to consider in determining the need for, and the nature and extent of, further action, including the threshold of credible evidence of substantial harm as one of those factors?
- (b) Do respondents agree with the imposition of the third party test relative to the determination of the need for, and nature and extent of, further action?
- (c) Do respondents agree with the examples of possible courses of further action? Are there other possible courses of further action respondents believe should be specified?
- (d) Do respondents support the list of factors to consider in determining whether to disclose the matter to an appropriate authority?

Answer 7

- (a) Factors to consider in determining the need for, and the nature and extent of, further action, including the threshold of credible evidence of substantial harm as one of those factors:

The need for, and the nature and extent of, further action, depends on factors like legal and regulatory framework, urgency of the matter, the principle of continued confidence in the integrity of the management, reoccurrence of the NOCLAR and the evidence of substantial harm to stakeholders. Consideration of these factors along with possible courses of action of disclosing to an appropriate authority and withdrawing from the engagement are imperative for auditors and senior PAIBs to response the NOCLAR.

- (b) The imposition of the third party test to the determine the need for, and nature and extent of, further action:

With the imposition of third party test, auditors and senior PAIBs are required to take into account whether a reasonable and informed third party, of all facts and circumstances available at the time, will conclude that they have acted in public interest. Conduct of third party test at the earlier stage in the process helps auditors and senior PAIBs to assess and determine the need for and nature and extent of further action. This test provides rationale basis to auditors and PAIBs for forming firm decision regarding further action.

- (c) Examples of possible courses of further action and other possible courses of further action respondents believe:

The proposal specifies two possible courses of action that is, disclosing the matter to an appropriate authority, even if there is no legal or regulatory requirement or withdrawing from the engagement and the client relationship. These further action acts as pressure release valves and are appropriate steps for auditors and senior PAIBs for dealing with the NOCLAR.

- (d) List of factors to consider in determining whether to disclose the matter to an appropriate authority:

The list of factors such as, listing of client on a securities exchange, existence of an appropriate authority, actual or potential threats to the physical safety of the PA or other individual and the like are supportive to consider in determining whether to disclose the matter to an appropriate authority.

Question 8

For PAs in public practice providing services other than audits, do respondents agree with the proposed level of obligation with respect to communicating the matter to a network firm where the client is also an audit client of the network firm?

Answer 8

The proposed level of obligation is appropriate with respect to communicating the matter to a network firm where the client is also an audit client of the network firm.

Question 9

Do respondents agree with the approach to documentation with respect to the four categories of PAs?

Answer 9

The approach to documentation with respect to auditors is same as required under different ISAs, that is documenting how management and/or TCWG have responded to the matter, courses of action considered, judgments and decision reached having regard to the reasonable and informed third party test and how auditors satisfied themselves that they have duly satisfied the requirements of the code.

For other three categories of PAs, documentation is not necessitated but encouraged. Encouragement of documentation for other two categories of PAs, that is, PAs in public practice providing services other than audits and Other PAIBs is justified but documentation for Senior PAIBs should be made compulsory as of auditors.

Senior PAIBs include Director or senior level employees who are able to exert significant influence over, and make decisions regarding acquisition, deployment and control of human, financial, technological, physical and intangible resources. Considering the further course of action of disclosing the NOCLAR to an appropriate authority even if not required by law or regulation, makes documentation necessary, as these may be referred in any point in time in case of any legal proceedings.