

4 September 2015

Mr Ken Siong
Technical Director
International Ethics Standards Board for Accountants
International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, NY 10017
USA

Dear Ken,

IESBA Exposure Draft *Responding to Non-Compliance with Laws and Regulations*

Thank you for the opportunity to comment on the IESBA re exposure draft of proposed changes to the Code addressing professional accountants' responses to non-compliance or suspected non-compliance with laws and regulations (NOCLAR). We submit the feedback from the New Zealand Auditing and Assurance Standards Board (NZAuASB) in the attachment.

NZAuASB's Role and Perspective

The NZAuASB is a sub-board of the External Reporting Board (XRB). The NZAuASB is responsible for developing (or adopting) and issuing auditing and assurance standards (including professional and ethical standards as they apply to assurance practitioners) in New Zealand. Once issued, these standards become legal instruments.

The NZAuASB's mandate only covers assurance engagements, not other professional services. The submission is based on the scope of the NZAuASB's responsibilities and therefore reflects its perspective as the issuer of instruments that create legal obligations for assurance practitioners. The NZAuASB's detailed response is therefore limited to the proposals for auditors of the financial statements and other assurance practitioners in public practice that provide assurance services to a client. The NZAuASB recognises that there may be different issues to consider for other professional accountants.

Overall summary

The NZAuASB commends the IESBA on the extensive deliberations and consultations undertaken to develop the proposed revised framework. The appropriate action to take where non-compliance with laws or regulations exists or is suspected, but disclosure is not mandated by legislation, is an area that can create significant concerns for auditors and other professional accountants (PAs), which is further complicated by the overarching ethical requirement of confidentiality. It is clear that the IESBA has considered and acted on the substantive concerns received on the original proposals. In particular, the concerns raised about the need to take account of regulatory arrangements within a jurisdiction, and the scope of the investigating and reporting.

Overall the NZAuASB believes that too much reliance or emphasis is placed on the obligations of the auditor, disproportionate to other professional accountants, and that the ethical obligations should be the same across all categories of PAs. The IAASB's *Framework for Audit Quality* demonstrates the importance of appropriate interactions among stakeholders and the importance of various contextual factors in ensuring quality audits. All members of the profession should therefore be subject to the same requirements and high standards to act in the public interest.

Should the IESBA continue to believe that there should be a differential approach among the categories of PAs, the NZAuASB's views of the proposed framework as it relates to assurance practitioners are as follows;

- (a) In summary, the NZAuASB is comfortable with the proposed scope of the laws and regulations for the auditor to be similar to that of ISA 250, and agrees that it is appropriate to complement the ISAs. However, the NZAuASB considers that the proposed scope of the laws and regulations is not appropriate for other assurance engagements where the subject matter is not financial statements. The proposals should not only complement the ISAs, but should also complement the International Standards on Assurance Engagements (ISAEs) that apply to other assurance services undertaken by assurance practitioners. Those standards refer to laws and regulations that have a direct effect on the subject matter of the engagement and do not refer to financial statements.
- (b) The NZAuASB is further of the view that the framework for audits of financials statements is appropriate for all assurance engagements, regardless of whether the subject matter of the engagement is the financial statements or some other subject specific matter. While other assurance engagements are not as regulated, the NZAuASB considers the framework proposed for auditors is equally appropriate to other assurance practitioners, and not overly onerous, as there are only minor differences in the section for auditors and the section for other professional accountants in public practice. Applying the same framework proposed for auditors to other assurance practitioners will increase quality, be more consistent with the other assurance standards and the expectations of the users of the assurance reports, avoid confusion, and streamline the Code. At the very least the same framework that applies to auditors should apply to assurance practitioners performing reviews of financial statements, to be consistent with S290 of the Code, which applies to audits and reviews.

In formulating this response, the NZAuASB sought input from New Zealand constituents.

Should you have any queries concerning our submission please contact either myself at the address details provided below or Sylvia van Dyk (sylvia.vandyk@xrb.govt.nz).

Yours sincerely,



Neil Cherry

Chairman – New Zealand Auditing and Assurance Standards Board

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Submission of the New Zealand Auditing and Assurance Standards Board

IESBA Exposure Draft *Responding to Non-Compliance with Laws and Regulations*

I Schedule of Responses to the IESBA's Questions

General Matters

1. Where law or regulation requires the reporting of identified or suspected NOCLAR to an appropriate authority, do respondents believe the guidance in the proposals would support the implementation and application of the legal regulatory requirement?

Response:

The NZAuASB's response is limited to the proposals for auditors of the financial statements and other assurance practitioners in public practice that provide other assurance services to a client.

The NZAuASB considers that the guidance is clear for auditors, but that the guidance for other assurance practitioners (performing assurance services other than audits of financial statements) could be clearer. There is a clear requirement in paragraph 225.19 for the auditor to comply with applicable laws and regulations governing the reporting of non-compliance to an appropriate authority. However, there is no such explicit requirement for assurance practitioners performing assurance services other than audits. Other assurance practitioners only need to consider the legal and regulatory framework when determining if further action is needed, and then only as one of many other factors noted (refer paragraph 225.42).

Recommendation

The NZAuASB recommends that paragraph 225.19 should also apply to other assurance practitioners performing other assurance services. The NZAuASB considers it appropriate to require the assurance practitioner to comply with applicable laws and regulations governing the reporting of NOCLAR to an appropriate authority in all assurance engagements, not just audits. This would already be addressed by the law and by the auditing and assurance standards, so there is no need for the Code of Ethics to only emphasise this point for audit engagements.

If the legislation applied more broadly than to an audit it should be complied with by the assurance practitioner and where the law does not cover other assurance engagements, expanding the requirement in the Code has no impact other than to streamline the Code.

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?

Response:

The NZAuASB's response is limited to the proposals for auditors of the financial statements and other assurance practitioners in public practice that provide other assurance services to a client.

The proposals are helpful but further clarification is needed about the responsibility of assurance practitioners when there is no legal or regulatory requirement to report identified or suspected NOCLAR to an appropriate authority. The framework is currently not clear on what the responsibility of the auditor is compared to an assurance practitioner that performs other assurance services and where that assurance practitioner communicates a NOCLAR matter to the auditor.

For example:

Paragraph 225.39 requires the professional accountant performing services other than an audit for an audit client to communicate a NOCLAR matter within the firm, to enable the engagement partner of the audit to be informed about it and to determine how it should be addressed in accordance with the provisions of section 225.

It is not clear how the auditor is required to act on this information compared to the professional accountant communicating the matter to the auditor. For example, paragraph 225.11 implies that section 225 is applicable “ if in the course of performing an audit of financial statements the professional accountant becomes aware of NOCLAR ...”. It is not clear what the auditor’s responsibilities are if the auditor is informed about the matter by another professional accountant at a time other than when the audit is in progress. Also, once the auditor is informed about the matter, whether the audit is in progress or not, it is not clear what the responsibilities are of the auditor compared to that of the other professional accountant.

A similar comment applies to paragraph 225.40, which states that the professional accountant may also consider communicating the matter to a network firm to enable the audit engagement partner of the firm *to be informed of it* (as opposed to *being informed about it and to determine how it should be addressed in accordance with the provisions of section 225*, which the auditor within the firm is required to do as per paragraph 225.39). The subtle difference between 225.39 and 225.40 needs to be further explained and clarified.

The NZAuASB believes that considering further action does not stop when a professional accountant in public practice performing a service other than an audit communicates the matter to the auditor. The primary responsibility for following up on any suspected illegal act should remain with the professional accountant, or other advisor, that identifies the concern, even after communicating the matter to the auditor.

The NZAuASB further notes that the proposals provide more guidance for the auditor when determining whether to disclose the matter to an appropriate authority than for assurance practitioners performing other assurance services for entities. The NZAuASB considers that the guidance in paras 225.27 to 225.28 is equally applicable and helpful to other assurance practitioners when considering whether to disclose the matter to an appropriate authority notwithstanding that there is no legal or regulatory requirement to do so.

Recommendations

- i. The reasons for communicating the matter to the auditor should be clarified in the standard, i.e. whether it is a professional courtesy to inform the auditor to consider it from a risk management perspective, or whether further action is required by the auditor. This may be what the subtle difference in wording in paragraph 225.39 and 225.40 is conveying, however, this is not clear.
- ii. The framework for auditors should specifically address the actions the auditor should take in those circumstances where another PA informs the auditor about a NOCLAR matter.
- iii. There should be a requirement that the responsibility for considering further action does not stop when an assurance practitioner performing an assurance service other than an audit communicates the matter to the auditor. It should be clear that the primary responsibility for following up on any suspected illegal act should remain with the professional accountant, or other advisor, that identifies the concern, even after communicating the matter to the auditor.
- iv. The NZAuASB believes that the proposed framework for auditors should also apply to other assurance practitioners. Should the IESBA continue to believe there should be differences, the NZAuASB recommends that the IESBA considers extending the guidance in paras 225. 27 and 225.28 to other assurance practitioners providing assurance services other than audits.

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

- a. **Auditors and audited entities;**
- b. **Other PAs in public practice and their clients; and**
- c. **PAIBs and their employing organisations**

Response:

The NZAuASB has not identified any practical issues as a result of the proposals.

Specific Matters.

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

Response:

The NZAuASB considers it is an appropriate objective for all categories of PAs. The NZAuASB believes that it makes it clear upfront about what is expected of PAs when they encounter a NOCLAR or suspected NOCLAR.

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

Response:

The NZAuASB's response is limited to the proposals for auditors of the financial statements and other assurance practitioners in public practice that provide other assurance services to a client.

The NZAuASB considers the proposed scope to be appropriate for assurance practitioners performing an audit or a review of financial statements, but not appropriate for assurance practitioners performing other assurance services where the subject matter is not financial statements.

The IESBA's proposed approach is inconsistent with the International Standards on Assurance Engagements (ISAEs) on a specific subject matter other than financial statements. Those standards refer to laws and regulations that have a direct effect on the subject matter of the engagement and do not refer to financial statements. The NZAuASB considers that the proposals should not only complement the ISAs, but should also complement the ISAEs that apply to other assurance services undertaken by PAs.

For example, ISAE 3410 *Assurance Engagements on Greenhouse Gas Statements* refers to laws and regulations recognised to have an effect on material amounts and disclosures in the Greenhouse Gas Statement. The NZAuASB considers that it is more appropriate for the practitioner to be expected to have a knowledge of laws and regulations specific to the subject matter of the engagement, rather than laws and regulations specific to the financial statements for all engagements.

Also, the NZAuASB notes that the scope of laws and regulations noted in proposed section 225 does not align with paragraph 225.37, which states that the professional accountant is not expected to have detailed knowledge of laws and regulations beyond that which is required for the professional service for which the accountant was engaged.

Recommendation

The NZAuASB recommends the following proposed modification:

Proposed modification

Scope

225.5 This section addresses:

- (a) Laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the underlying subject matter information (for example the client's financial statements in an audit engagement); and
- (b) Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the underlying subject matter information ~~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.

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

Response:

Overall the NZAuASB believes that too much reliance or emphasis is placed on the obligations of the auditor, disproportionate to other professional accountants, and that the ethical obligations should be the same across all categories of PAs. The IAASB's *Framework for Audit Quality* demonstrates the importance of appropriate interactions among stakeholders and the importance of various contextual factors in ensuring quality audits. All members of the profession should therefore be subject to the same requirements.

Should the IESBA continue to believe that there should be a differential approach among the categories of PAs, the NZAuASB does not agree that there should be a difference in approach between auditors and other assurance practitioners performing other assurance services. The NZAuASB notes that the difference in the responsibility of auditors as opposed to other assurance practitioners in the ED is very subtle. The two sections (one for auditors, the other for other assurance practitioners) are very similar, which makes it difficult to determine what the difference in the responsibilities of the auditors compared to the other assurance practitioners actually are, especially where there is no legal or regulatory requirement to report to an appropriate authority. These minor differences could actually confuse matters, and the NZAuASB queries the need to distinguish between auditors and other assurance practitioners.

The NZAuASB notes that IESBA's reason for not aligning the requirements is that the provision of a review and other assurance engagements varies significantly around the world and that audits tend to be significantly more legislated or regulated than other assurance engagements. While other assurance engagements are not as regulated, the NZAuASB still considers the same framework is equally appropriate, and not overly onerous, with an increase in quality, and would be more consistent with the other assurance standards and the expectations of the users of the assurance reports. There is no reason why the assurance practitioner should react differently if the engagement is an audit or some other assurance engagement where the assurance practitioner suspects or identifies NOCLAR.

The NZAuASB further notes that s290 equates the independence requirements for an audit and a review. It seems inconsistent therefore to draw a distinction between audit and review in s225 where no such distinction is made in s290. (From a clarity perspective, the IESBA code uses the term audit to mean audit and review in s290, and this inconsistency may result in confusion and misapplication in practice). At the very least the proposed framework for auditors should apply to assurance practitioners performing review engagements.

The main differences between the audit and other assurance framework as proposed is that the following two steps only apply to an audit: a) If applicable, the auditor shall prompt management and those charged with governance to take appropriate action and b). The auditor shall comply with applicable laws and regulations, including requirements of reporting to an appropriate authority, and professional standards including the implications for the auditor's report. These are not onerous requirements for all assurance engagements and would be followed in practice in any event.

The NZAuASB considers that where management or those charged with governance agree that non-compliance has or may occur, it is appropriate for the assurance practitioner in a review engagement or other assurance

engagement to prompt them to take appropriate and timely action, after discussing the matter with them. That is, it is appropriate for this to be required in all assurance engagements.

The NZAuASB similarly considers it appropriate to require the assurance practitioner to comply with applicable laws and regulations governing the reporting of NOCLAR to an appropriate authority in all assurance engagements, not just audits. This would already be addressed by the law (i.e. if the legislation applied more broadly than to an audit it should be complied with by the assurance practitioner and where the law does not cover other assurance engagements, expanding the requirement in the Code has no impact other than to streamline the Code) and by the auditing and assurance standards, so there is no need for the Code of Ethics to only emphasise this point for audit engagements.

The NZAuASB further considers that it is also relevant, as a professional courtesy, for the external auditor to consider informing other assurance practitioners engaged by the audit client about NOCLAR matters the auditor discovered.

Recommendation

The NZAuASB recommends that the IESBA:

- i. aligns the requirements for auditors and other practitioners performing assurance engagements.
- ii. considers whether it would also be relevant for the external auditor, as a professional courtesy, to consider informing other assurance practitioners engaged by the audit client for recurring assurance engagements about NOCLAR matters the auditor discovered, where the matter is relevant to the other engagement.

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?***

Response:

The NZAuASB's response is limited to the proposals for auditors of the financial statements and other assurance practitioners in public practice that provide other assurance services to a client.

The NZAuASB agrees with the factors to consider in determining the need for further action for auditors. In respect of the threshold of "credible evidence of substantial harm" as one of those factors, the NZAuASB notes that the equivalent threshold for other practitioners (paragraph 225.42) is "the likelihood of substantial harm to the interests...". It is not clear why there is a lower threshold than for auditors. The subtle difference in the factors to be considered by auditors compared to other assurance practitioners is also confusing. As recommended above under question 6, the NZAuASB considers that the proposed framework for auditors should also apply to other assurance practitioners.

The NZAuASB agrees with the imposition of the third party test and recommends that the test should also be applicable to other assurance practitioners.

The NZAuASB agrees with the examples of further action and has not identified any further actions.

The NZAuASB supports the list of factors to consider in determining whether to disclose the matter to an appropriate authority. The NZAuASB notes that the guidance for professional accountants in public practice in 225.44 is limited compared to the guidance provided to auditors in paras 225.27 and 225.28. Should the IESBA continue to believe there should be differences, the NZAuASB recommends that the IESBA considers extending the guidance in paras 225.27 and 225.28 to assurance practitioners providing assurance services other than audits.

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?

Response:

The NZAuASB agrees with the IESBA's reasons that it is not appropriate to mandate reporting to a network firm without appropriate consideration of the context and the circumstances. However, as noted in the response to question 2, the reason for the communication is not clear, i.e. whether it is a professional courtesy to inform the auditor to consider it from a risk management perspective, or whether further action is required by the auditor. This may be what the subtle difference in wording in paragraph 225.39 and 225.40 is conveying, however, this is not clear. The NZAuASB recommends that the reasons for communicating the matter to the auditor be clarified in the standard.

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

Response:

The NZAuASB's response is limited to the proposals for auditors of the financial statements and other assurance practitioners in public practice that provide other assurance services to a client.

The documentation requirement for auditors is appropriate given the higher expectations of their role. Auditors are already required under the ISAs to document NOCLAR and the other document requirements appropriately cover the specific considerations, judgements and decisions with respect to NOCLAR or suspected NOCLAR judged by auditors to be a significant matter.

The NZAuASB considers that the audit documentation requirement for auditors should be extended to apply to all other assurance practitioners. The international standard on review engagements ISRE 2410 and other ISAEs also require rather than encourage documentation, therefore expanding the audit documentation requirement to all assurance engagements would be consistent with principles and practices required by those standards. The modifications would reduce inconsistencies between the Code of Ethics and the requirements of the other assurance standards. The modification will simplify the framework as it would apply to all assurance engagements in the same way and will avoid unnecessary repetition in the Code.