



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

September 1st, 2015

Re: IESBA Exposure Draft – Responding to Non-Compliance with Laws and Regulations (NOCLAR)

Dear Mr Siong

Introduction

We¹ appreciate and thank you for the opportunity to comment on the IESBA’s Exposure Draft (ED) “Responding to Non-Compliance with Laws and Regulations”.

Principal comments

We believe that the revised proposals represent a significant improvement to the original proposals. We expressed strong reservations and concerns about the original proposals, including the mandatory requirement to report to an appropriate authority. We, and many others, questioned the operability of the proposals, whether they were appropriately balanced, and the potential for unintended consequences. The revised proposals address many of the concerns expressed and we congratulate the Board. We appreciate that this has not been easy, given the legal and practical considerations involved, and we recognise the tremendous efforts that the Board has made in reconciling the various views and expectations that have been expressed by different stakeholders to forge consensus.

¹ This response is being filed on behalf of PricewaterhouseCoopers International Limited (PwCIL). References to “PwC”, “we” and “our” refer to PwCIL and its global network of member firms, each of which is a separate and independent legal entity.

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In particular, we support how the proposals frame reporting externally to an appropriate authority as an important consideration for the professional accountant, rather than a mandatory requirement. The approach, including the factors introduced to guide the professional accountant in that difficult judgement, is, for the most part, now appropriate and workable. We have, therefore, limited our comments to these few key matters on which we have some remaining concern and encourage the Board to address these as it reflects on the responses to the ED.

Detailed comments

Forensic services

In our letter on the original ED, we expressed concern that an expectation that a professional accountant providing forensic services might, in certain circumstances, be obliged to report NOCLAR to parties external to the client could deter companies from hiring the very expertise they need to investigate issues. We have a similar concern with the revised proposals.

We recognise that proposed 225.44 states that a factor to consider in evaluating any need to disclose a matter outside the client is whether legal privilege exists. In practice, however, much forensic work performed in accountancy firms is not performed by lawyers or under legal privilege and so this consideration is of limited help. The second bullet refers broadly to “whether the terms or nature of the engagement precludes disclosure”, which might be argued to apply to forensic work (i.e., the nature of that work would preclude disclosure to be effective). However, the example of legal privilege left some of our readers to believe that the bullet is limited to circumstances when there is a legal basis to evidence the “preclusion”.

If forensic work is not explicitly exempted, we remain concerned that companies will be dissuaded from hiring professional accountants to perform forensic work, which could hinder the ability of the company to hire the necessary expertise to deal with an issue and to “do the right thing” – it is this that is foremost in the public interest in these situations.

Therefore, we strongly recommend that the code explicitly clarify that a professional accountant providing forensic services would report their findings to management or those charged with governance only and would not need to consider further reporting to parties external to the client. The sole responsibility for any further action in these circumstances should remain with the client.

Compliance with local laws and regulations

Paragraph 225.44 (first bullet) makes it clear that disclosure to parties external to the client would not be possible if contrary to law or regulation, and paragraphs 225.10 and 225.33 instruct the professional accountant to obtain an understanding of such provisions and comply with them. This is a very important provision as a professional accountant would be in an irreconcilable position if professional responsibilities required violation of laws or regulation.



In the UK, for example, under the UK Proceeds of Crime Act 2002, firms have an obligation to report to the National Crime Agency (NCA) any knowledge or suspicion of criminal activity encountered during the course of business, where such criminal activity is thought to have given rise to the proceeds of crime. There is, therefore, an external reporting requirement under law, with appropriate protections in place. At the same time, it is also a criminal offence to disclose information to management or those charged with governance or others that is likely to prejudice any law enforcement investigation. We believe this is the intent of the ED proposals (see paragraph 225.10). However, some have suggested that the drafting does not make it clear that, in such circumstances, the professional accountant would not be expected to comply with the requirement to discuss the matter with management and those charged with governance. This internal inconsistency warrants clarification and we offer the following suggestions.

The need to avoid “tipping off” is mentioned in the third bullet of paragraph 225.44, but only in the context of restrictions on disclosures imposed by a regulatory agency or prosecutor. We recommend that this also be reflected in the first bullet. We also believe, for example in the context of the UK requirements, that this is equally applicable in the context of an audit and therefore recommend that the avoidance of “tipping off” be mentioned again in the last sentence of 225.27.

Finally, we believe that paragraphs 225.10 and 225.33 should explicitly explain that the professional accountant’s obligations under law or regulation override the requirements in the section – for example, where law or regulation prohibit disclosure, the professional accountant would not be expected to consider disclosure to parties external to the client.

NOCLAR involving a party other than the client appointing the professional accountant to act

Paragraph 36 of the Explanatory Memorandum helpfully explains that *“The revised proposals are intended to cover only situations where the PA has a direct (contractual) relationship with a client (such as through an audit or other assurance engagement or the provision of non-assurance services), or, for PAIBs, where there is an employment relationship. The proposals are not intended to apply to circumstances where the PA has no direct relationship with the party suspected of committing an act contrary to prevailing laws or regulations. These include, for example, circumstances where a PA has been engaged by a client to perform a due diligence assignment on a third party entity and the identified or suspected NOCLAR has been committed by that third party”*.

We concur with this. There are services, including buy-side due diligence, where a professional accountant may come across a NOCLAR at another organisation that has not appointed the professional accountant. In cases where the other party is not a client of the professional accountant or firm, the professional accountant will not have a direct relationship with that other party and no (or little) access to management nor the ability to address the matter in accordance with the proposals. In practice, acts by a third party entity are, in most instances, unlikely to be covered by the matters which the section addresses as detailed in paragraph 225.5 of the proposals.

However, paragraph 225.8(c) states as part of the introduction and scoping that the section does not address *“Non-compliance with laws and regulations committed by persons other than the client, those charged with governance, management or employees of the client. The professional*



accountant may nevertheless find the guidance in this section helpful in considering how to respond in these situations.”

For the reasons above, the first sentence is a very important statement and we believe that this exclusion from the scope of the proposals is appropriate and pragmatic. We note, however, that the text of the proposal does not fully capture the notion of having a direct contractual relationship with the entity that is engaging the professional accountant to perform the service. We suggest that paragraph 225.8(c) could be re-worded as follows to indicate that the section does not address:

“Non-compliance with laws and regulations committed by persons other than the client with whom the professional accountant has a direct contractual relationship in relation to the professional service, those charged with governance, management or employees of that client. This includes, for example, circumstances where a professional accountant has been engaged by a client to perform a due diligence assignment on a third party entity and the identified or suspected NOCLAR has been committed by that third party”.

We also believe that there is some unhelpful ambiguity created by the second sentence of paragraph 225.8, above, as it could be read to suggest that in certain circumstances there may be professional responsibilities to consider where either (a) the third party entity is not a client or (b) the third party entity is a client of the firm. On balance, we consider that it may be best to leave these types of situations to professional judgement and to laws and regulations that provide an appropriate framework and safeguards. Accordingly, we recommend deleting the second sentence of 225.8(c) to avoid any ambiguity.

Alignment with the ISAs

We recognise that the changes to the Code has implications for the content of the ISAs – in particular for ISAs 250 and 240 – and that the IAASB is taking current steps to address this. We believe that alignment between the Code and the ISAs is imperative. We recognise that it is not necessary to comply with the IESBA Code of Ethics to comply with the ISAs and vice versa, and therefore some might argue that alignment is not necessary, particularly with respect to the reporting obligations. However, there will be a significant number of auditors and audit firms that comply with both (including members of the Forum of Firms through their membership obligations). For this reason, we believe that, at a minimum, the work effort should be consistent to avoid the auditor having to reference two different standards to determine what to do. We therefore encourage the two Boards to work together to achieve this goal.

Referring to the possibility of disclosing the non-compliance in the auditor’s report

We believe that paragraph 225.19 could have unintended consequences. Some have interpreted the phrase “consideration of the implications of the matter for the auditor’s report, *including disclosure in the report*” as suggesting that an identified or suspected NOCLAR would ordinarily be considered a key audit matter under ISA 701.

The proposed guidance in the Code deals with the difficult judgments involved in determining whether to disclose the matter *privately* to an appropriate authority; it would be entirely inconsistent to suggest that the matter might readily be included in the auditor’s *public* report. ISA 701



acknowledges that there are circumstances when matters should not be communicated because the adverse consequences would reasonably be expected to outweigh the public interest benefits of such communication. A NOCLAR could reasonably be one of those circumstances.

For these reasons, we suggest that the phrase “including disclosure in the report” be deleted and simply leave the requirement as considering the “implications of the matter for the auditor’s report”. This would still leave the auditor the discretion to use professional judgment to determine whether a particular matter of non-compliance should be included as a key audit matter, taking into account the guidance in ISA 701.

Contact

We would be happy to discuss our views with you. If you have any questions regarding this letter, please contact Diana Hillier (at diana.hillier@uk.pwc.com), or me, at jan.e.mccahey@uk.pwc.com.

Yours sincerely

A handwritten signature in cursive script that reads "Jan McCahey".

Jan McCahey
Global Regulatory Leader



Appendix 1

Detailed comments

Paras 225.3 (c)
and 225.20

There is a circular logic in that the objective refers to taking such further action as may be *needed* in the public interest, but the proposals also require the professional accountant to determine if further action is *needed* to achieve the professional accountant's objective under this section.

We find paragraph 225.25 helpful in providing a useful context in which to frame this judgement – a professional judgement, taking into account how the situation might be seen by a reasonable and informed third party, weighing the specific facts and circumstances available at the time.

However, we suggest merging paragraphs 225.25 and 225.20 so this context frames the professional accountant's thought process in the judgements being made in paragraphs 225.21 – 225. 24, and the circular logic is avoided, as follows:

“225.20 The professional accountant shall exercise professional judgment in determining whether further action is needed, taking into account whether a reasonable and informed third party, weighing all the specific facts and circumstances available to the professional accountant at the time, would be likely to conclude that the professional accountant has acted appropriately in the public interest.”

For the same reason, we recommend merging paragraphs 225.45 and 225.41, and also paragraphs 360.24 and 360.19.