

**NOCLAR—Issues and Task Force Proposals****I. Background***January 2015 IESBA Meeting*

1. At the January 2015 meeting, the Board considered a revised draft of the proposed Sections 225<sup>1</sup> and 360.<sup>2</sup> The Board also considered a draft rationale for the proposed framework for responding to non-compliance or suspected non-compliance with laws and regulations (NOCLAR). The Task Force had developed the draft rationale to explain the strengths of the proposed framework for purposes of the explanatory memorandum to accompany the re-exposure draft (re-ED).
2. The Board supported the direction of the draft Sections 225 and 360. In particular, the Board tentatively agreed the following:
  - The additional guidance and clarification regarding the scope of the two Sections, subject to some refinements.
  - The approach to scoping out matters that are clearly inconsequential.
  - The placement of the third party test regarding the need for, and nature and extent, of further action to achieve the objectives under each Section.
  - The need to revisit the list of factors to consider in determining whether or not to disclose the matter to an appropriate authority to ensure a more balanced presentation of these factors.
3. The Board also tentatively supported:
  - The draft rationale for the proposed response framework.
  - The inclusion of flow charts in the re-ED package to illustrate the application of the two proposed Sections, with appropriate caveats regarding the use of such flow charts.
4. Based on the Board discussion, the Task Force has fine-tuned the draft Sections 225 and 360 as shown in Agenda Item 2-B. The Task Force has also received a number of helpful editorial suggestions from Board members and Technical Advisors, which have been incorporated into the revised text. To facilitate the Board's review and deliberation, these editorial suggestions are not shown in Agenda Item 2-B. For completeness, they are shown in mark-up in Agenda Item 2-C. Also for purposes of aiding Board members' review of the revised text, the Task Force has added explanations of the main changes in the margins of Agenda Item 2-B.
5. The Task Force's responses to the main matters raised at the January 2015 Board meeting are set out in the table in Section II.A below. Changes to the text have generally been made first to proposed Section 225, with corresponding changes then to proposed Section 360 where appropriate.
6. The Task Force is also proposing a few consequential changes to other sections of the Code. These are set out in Agenda Item 2-E.

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<sup>1</sup> Proposed Section 225, *Responding to Non-Compliance or Suspected Non-Compliance with Laws and Regulations*

<sup>2</sup> Proposed Section 360, *Responding to Non-Compliance or Suspected Non-Compliance with Laws and Regulations*

*IOSCO Committee 1 Meeting*

7. Board leadership and Task Force representatives attended the IOSCO Committee 1 meeting in early February to present an update on the project. Overall, there were no significant concerns from Committee 1 regarding the proposed response framework. Participants, however, raised a few points of detail on the draft text of Sections 225 and 360. These are outlined in Section II.B below.

*March 2015 IESBA CAG Meeting*

8. At the March CAG meeting, the Chair of the Task Force briefed the CAG on the latest developments in the project, including the main changes to the draft text of Sections 225 and 360 since the September 2014 CAG meeting in the light of the October 2014 and January 2015 Board deliberations. The draft rationale for the proposed framework was also shared with the CAG for information.
9. The CAG supported the direction of the revised text and overwhelmingly supported the Board issuing it for re-exposure, subject to Board consideration of a number of detailed comments and suggestions on the text. A summary of the CAG comments, together with the Task Force's responses, is included in Agenda Item 2-F.
10. Some CAG Representatives noted that the draft rationale for the proposed framework was helpful and suggested that it be made publicly available with the final standard in due course.

*Comments from IFAC Small and Medium Practices (SMP) Committee*

11. On January 9<sup>th</sup>, the IFAC SMP Committee submitted a comment letter to the Task Force on the January 2015 Board agenda material for the project. Due to the timing of the letter, the Task Force did not have an opportunity to reflect on the comments before the January Board meeting. The Task Force, however, subsequently considered the SMP Committee's input at its meeting later in January.
12. The SMP Committee's comments and the Task Force's responses are set out in Agenda Item 2-G.

**II. Significant Matters**

**A. January 2015 Board Meeting**

13. The main matters raised at the January meeting and the Task Force's responses are as follows (comments are in relation to proposed Section 225 unless otherwise noted):

#	Matters Raised	Task Force Responses
1.	Whether the structure and flow of the introductory section could be improved through better signposting.	Point accepted. See revised text.
2.	In relation to the objectives, whether there would be merit in stating what the range of further action might be to help enhance the presentation of these objectives.	Point not accepted. The Task Force believes that this would render the objectives unduly granular.
3.	Whether there was an inconsistency between the first paragraph of the Section (which refers to	The Task Force did not believe that there is an inconsistency as the proposed Section

#	Matters Raised	Task Force Responses
	substantial harm in <i>non-financial</i> terms) and the second category of laws and regulations within the scope (which have an indirect effect on the financial statements). In this regard, it was felt that the former appeared to have expanded the scope of ISA 250 <sup>3</sup> as it would be difficult to envisage a NOCLAR that would not have an indirect effect on the financial statements.	225 and ISA 250 have different objectives. The Task Force believes that it is necessary from an ethical perspective to consider the implications of non-compliance or suspected non-compliance for stakeholders also in non-financial terms, not only in financial terms.
4.	Whether the Section would capture a NOCLAR for which the public interest impact would be high but in respect of which the legal penalties would be immaterial.	The Task Force believes that a NOCLAR with high public interest impact would relate to laws and regulations fundamental to the entity's business or operations, and therefore in scope.
5.	Whether the examples of NOCLAR would suggest that the proposed Section addressed only serious matters.	Point accepted. The Task Force has made refinements to the introductory section to eliminate this perception.
6.	In relation to the examples of the second category of laws and regulations within the scope, including a reference to the banking sector and violation of banking laws as an example of NOCLAR in that regard, given the importance of this sector to the global economy.	Point accepted. See paragraph 225.6.
7.	In relation to the paragraph describing the responsibilities of professional accountants (PAs) in public practice, reconsidering how the requirement to obtain an understanding of laws and regulations is articulated as it seemed to be a standalone requirement unrelated to NOCLAR.	Point not accepted. The Task Force believes that the PA's compliance with applicable laws and regulations, and therefore the need to understand them, would only be triggered when the PA comes across an instance of NOCLAR or suspected NOCLAR.
8.	Reconsidering the need to define the concept of credible evidence as it is a legal standard in some jurisdictions.	Point accepted. The proposed guidance has been deleted.
9.	In relation to the examples of circumstances that may cause the PA no longer to have confidence in the integrity of those charged with governance, reconsidering the appropriateness of the second	Point accepted. See paragraph 225.24.

<sup>3</sup> ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*

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#	Matters Raised	Task Force Responses
	example as it seemed to suggest that the PA should judge whether management should act in the public interest, i.e., a level of obligation similar to the PA's. It was felt that this would be going too far.	
10.	Whether the placement of the threshold of credible evidence of substantial harm would suggest that the response framework would apply only to serious matters.	Point accepted. The Task Force has relinked this threshold to the list of factors to take into account in determining the nature and extent of further action. See paragraph 225.22.
11.	Deleting the statement that the concept of the public interest is not capable of general definition as such a statement would be inappropriate in a code of ethics.	Point accepted.
12.	Whether there was an implicit presumption of disclosure to an appropriate authority in paragraph 225.28, as the way it was drafted seemed to suggest that disclosure would be the expected outcome in the normal course of events unless the factors listed (e.g., threats to physical safety, etc.) were met.	Point taken into account. The Task Force has rebalanced the presentation of the factors to consider so as to make it clearer that the determination will be a matter of professional judgment.
13.	Re-balancing the list of factors affecting the determination of whether to disclose the NOCLAR or suspected NOCLAR to an appropriate authority, in particular by referring to the potential impact on investors and the financial market, and whether the matter could pose a systemic risk to the market or its stability.	Point accepted. See paragraph 225.28.
14.	Reconsidering the articulation of the third party test, as the focus appeared to be more on the third party (whose view can change) than on the public interest.	Point not accepted. The Task Force notes that the way the third party test is worded is consistent with how it is worded in the rest of the Code. The Task Force believes that introducing a different formulation will create confusion.
15.	In relation to the guidance concerning the factors to consider in determining whether PAs other than auditors can disclose information outside the entity, whether there would be a need to refer to the substantial harm threshold. The provision was	Point not accepted. The substantial harm threshold is already in the list of factors to consider in determining the nature and extent of further action. Adding it here would be duplicative.

#	Matters Raised	Task Force Responses
	perceived to suggest that such action would be entirely discretionary.	
16.	Whether the guidance for auditors regarding the factors affecting the determination of whether to disclose the matter to an appropriate authority should also be provided for PAs providing services other than audits.	Point considered. The Task Force believes that replicating the guidance for auditors would create a perception that PAs who are providing services other than audits have the same level of obligation as those performing audits, which is not the intention of the response framework.
17.	In the list of factors to consider in determining the nature and extent of further action, whether it was appropriate to refer to a general culture within the client of disregarding laws and regulations. It was felt that if that were the case, the PA should not continue the client relationship.	Point accepted. This item has been deleted.
18.	Reconsidering the proposed guidance on documentation as it seemed to convey the impression that the PA should manipulate the documentation to avoid legal discovery.	Point accepted. Guidance redrafted and proposed to be moved to the level of the broader Code as a consequential change to Section 100.
19.	In proposed Section 360, aligning the definition of a senior PA in business (PAIB) with the revised description of management responsibility as approved by the Board in the Non-Assurance services (NAS) project.	Point accepted. See paragraph 360.12.
20.	Whether proposed Section 360 should address the situation where the immediate superior is suspected of being involved in the NOCLAR and the entity has no internal ethics policy that would provide an alternative channel for raising the matter.	Point accepted. See paragraphs 360.16 and 360.33.
21.	Clarifying that for PAIBs other than senior PAIBs, they would be permitted to go further than their immediate superior in raising the matter.	Point accepted. See paragraph 360.34.

**Matter for Consideration**

1. IESBA members are asked whether they agree with the Task Force’s responses.

**B. February 2015 IOSCO Committee 1 Meeting**

14. The main matters raised at the IOSCO Committee 1 meeting and the Task Force’s responses are as follows (comments are in relation to proposed Section 225 unless otherwise noted):

#	Matters Raised	Task Force Responses
1.	Whether insider trading would be captured within the scope of covered NOCLARs as this could have a reputational impact on the entity and therefore on the financial statements.	Point taken into account. The Task Force believes that insider trading would be addressed under securities laws and regulations. Accordingly, the Task Force proposes that these laws and regulations be included in the list of examples of laws and regulations in paragraph 225.6.
2.	In relation to documentation, it was unclear that auditors would be required to document their consideration of next steps if management/TCWG have not appropriately responded to the matter or if they do not agree that there is an issue.	Point accepted. See paragraph 225.33.
3.	With the proposed high threshold for reporting, it was unclear that PAs with direct responsibility for health and safety matters, for example, would now have any obligation to report NOCLAR or suspected NOCLAR that falls below that threshold.	Point considered. See Task Force response to CAG comment #34 in Agenda Item 2-F.
4.	It was unclear whether non-compliance with disclosure requirements for management/TCWG under securities regulation would be covered under the proposed standard.	Point accepted. The Task Force proposes to add a reference to laws and regulations applicable to the securities markets. See paragraph 225.6.
5.	The proposed requirement for PAs providing services other than audits to “consider” reporting NOCLAR/suspected NOCLAR to the audit engagement partner where the client is also a client of the firm sounded weak and optional. It was suggested that the provision be strengthened so that there is a clear requirement to inform the latter.	Point accepted. See paragraph 225.40-41. The Task Force believes it should only be a requirement to consider reporting the matter where the client is an audit client of a network firm for the reasons set out in paragraphs 17-18 of the January 2015 Board issues paper.

**Matter for Consideration**

2. Do IESBA members agree with the Task Force's responses to the input received from IOSCO Committee 1?

**C. Consideration of the Need for Re-Exposure**

15. The Board's due process and working procedures require that prior to finalizing the revised content of an exposed international pronouncement, the Board determine whether there has been substantial change to the exposed document such that re-exposure would be necessary. They also require that when an ED has been subject to many changes, a summary comparative analysis be presented to the Board showing, to the extent practicable, the differences between the ED and the proposed final international pronouncement. This summary comparative analysis is presented in Agenda Item 2-H.
16. Under the due process and working procedures, situations that constitute potential grounds for a decision to re-expose may include, for example:
  - Substantial change to a proposal arising from matters not aired in the ED such that commentators have not had an opportunity to make their views known to the Board before it reaches a final conclusion;
  - Substantial change arising from matters not previously deliberated by the Board; or
  - Substantial change to the substance of a proposed international pronouncement.
17. On the basis of Agenda Item 2-H and the Board's extensive deliberations on the project and consultations with stakeholders since the comment period on the [original ED](#) closed, the Task Force believes that re-exposure of the revised proposals would be necessary. The Task Force therefore recommends, subject to the Board's deliberations at this meeting, that the Board votes to approve the revised proposals (including the related consequential and conforming amendments) for re-exposure.

**Matter for Consideration**

3. Do IESBA members agree that the revised proposals should be issued for re-exposure?

**D. Proposed Effective Date**

18. The Task Force understands that the Planning Committee has given some consideration to coordinating the effective dates of upcoming changes to the Code arising from projects currently in progress. The Task Force therefore defers any recommendation of what the effective date for the proposed standard might be to the Planning Committee, assuming Board approval of the proposed standard by Q1 2016.