

NOCLAR—Report-Back on March 2015 CAG Discussion

Below are extracts from the draft minutes of the March 2015 CAG meeting,¹ and an indication of how the Task Force has responded to CAG Representatives' comments

Matters Raised	Task Force Response
<p>1. Ms. Gardner introduced the topic, outlining the most recent CAG and Board discussions on the project. Among other matters, she highlighted the strengths of the proposed framework for professional accountants (PAs) to respond to NOCLAR or suspected NOCLAR. She also noted that the proposed standard was intended to build on and complement ISA 250.² In the context of the IESBA's liaison with the International Auditing and Assurance Standards Board (IAASB) in this regard, she would be attending the IAASB meeting the following week to present an update on the project. She then led the CAG through the issues presented.</p> <p>The following matters were raised.</p>	<p>–</p>
<p>GENERAL COMMENTS AND OBSERVATIONS</p>	
<p>2. Ms. Elliott acknowledged the significant amount of effort that has gone into the project. She highlighted that the Organization for Economic Cooperation and Development (OECD) frequently encourages the signatory countries to its Anti-Bribery Convention to adopt its 2009 <i>Recommendation for Further Combating Bribery of Foreign Public Officials in International Business</i>, which strengthens its framework for fighting foreign bribery. She emphasized the importance of auditors responding appropriately to NOCLAR or suspected NOCLAR, and not turning a blind eye to it. In this regard, she highlighted a recent case in the Netherlands where a large firm was</p>	<p>Ms. Gardner noted that the Board's aim is to have the Code drive PAs to do the right thing in the public interest. However, the Board was not discounting individual jurisdictions setting their own laws and regulations to address such issues.</p>

¹ The draft minutes will be approved at the September 2015 IESBA CAG meeting.

² ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*

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<p>fined €7 million for effectively turning a blind eye to evidence of foreign bribery by one of its clients.</p>	
<p>3. Mr. Hansen noted that the draft rationale for the proposed framework was well thought out. He wondered whether there was a way to make it publicly available once the standard is finalized.</p>	<p>Mr. Siong noted that this suggestion would be considered by the Board in due course.</p>
<p>4. Ms. Lang suggested that the wording used in Ms. Gardner's presentation to describe the overall purpose of the framework (i.e. to guide PAs in deciding how best to serve public interest when they come across NOCLAR or suspected NOCLAR) would be useful in the introduction to the proposed standard.</p>	<p>Point not accepted.</p> <p>The Task Force believes that the concept of serving the public interest has been appropriately expressed in the context of the specific objectives in paragraph 225.3 and with reference to the PA's responsibility to act in the public interest.</p>
<p>5. Mr. Muis wondered whether there was an underlying value system in the proposals that could be promoted globally. He felt that it would be very important for PAs to face the public interest directly and respond appropriately, and not aid and abet non-compliance in jurisdictions where laws and regulations are grossly violated. In this regard, he noted that while some legislators are good at addressing NOCLAR, others are less so.</p>	<p>Ms. Gardner responded that the public interest is at the heart of this project and that the proposed standard provides a pathway to disclosure to an appropriate authority, and therefore for an override of the duty of confidentiality, in the appropriate circumstances. However, the Board also recognized the need for the Code to operate in the context of local laws and regulations. She added that there is a need for the whole system to operate cohesively with all stakeholders playing their parts. In that context, she believed that the proposed standard was heading in the right direction.</p> <p>Dr. Thomadakis highlighted the distinct benefit to the bottom-up approach in the proposed standard, noting that this approach would work well in both jurisdictions that already have a legal or regulatory requirement for reporting of NOCLAR and those that do not. He added that the standard should not hinder reporting where required by law or regulation. At the same time, it should also not create a disincentive to reporting where this is not mandated under law or regulation.</p>
<p>6. Mr. Muis suggested that the explanatory memorandum to the re-exposure draft (re-ED)</p>	<p>Point to be taken into account in finalizing the explanatory memorandum.</p>

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<p>explain the dilemmas and the limits of what is possible under the proposed standard.</p>	
<p>7. Mr. Michel expressed support for the direction of the proposed standard, noting that it was comprehensive.</p>	<p>Support noted.</p>
<p>8. Ms. Borgerth expressed support for the direction of the proposed standard. She noted that under Brazilian regulation, auditors are required to inform those charged with governance (TCWG) of instances of NOCLAR or suspected NOCLAR, and that TCWG in turn have legal responsibilities to address the matter.</p>	<p>Support and point noted.</p>
<p>SCOPE</p>	
<p>9. Mr. Hansen wondered why there should be a distinction between audits and reviews with respect to PAs in public practice, given that both types of services come under the umbrella of attest services and that PAs would also have access to TCWG when performing review engagements. Accordingly, he wondered whether the right split should not be between attest and non-attest services as opposed to audits and other services.</p>	<p>Point considered.</p> <p>The Task Force believes that the current differential approach is appropriate because the use of review engagements around the world varies significantly, as does the level of public interest in them. There is similar wide variation in other assurance engagements that are not audits of financial statements. Also, lawmakers and regulators around the world have tended to legislate or regulate audits as opposed to other assurance engagements.</p> <p>The Task Force is of the view that jurisdictions would not be precluded from extending the proposed approach to review and other assurance engagements that are not audits, should they believe that doing so would be appropriate for their national contexts.</p>
<p>10. Mr. Fukushima noted improvement in the description of the scope of the proposed standard. However, he wondered whether an instance of NOCLAR that could undermine the reputation of the entity but which might not necessarily result in substantial harm to the public would be in scope. He suggested, as an</p>	<p>Ms. Gardner noted that the Task Force intended such a type of NOCLAR to be covered through the reference to securities laws and regulations in the list of examples of laws and examples which the proposed standard would address.</p> <p>Point considered. The Task Force believes that insider trading at an institutional level (including</p>

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<p>example, insider trading which could have a significant impact from a public interest perspective. Mr. James commented that insider trading may have no direct or indirect effect on the financial statements.</p>	<p>where perpetrated by management) would be captured under the proposals. At a personal level, however, it would likely not as fines would not be levied at the corporate level. While individuals convicted of insider trading may face significant personal consequences, this would not necessarily result in a significant adverse impact on the entity, reputational or otherwise.</p>
<p>11. Ms. Miller noted that she had an opposite concern in that the scope appeared very broad, particularly given the reference in the draft text to “laws and regulations compliance with which may be fundamental to the operating aspects of the client’s business.” She highlighted the risk of reporting a matter that would turn out not to be actual non-compliance.</p>	<p>Ms. Gardner noted that the challenge for the Board had been to find the right balance. The Task Force had endeavored to make clear that the auditor is not being asked to search for NOCLAR but rather to respond <i>upon becoming aware</i> of information suggesting an instance of NOCLAR or suspected NOCLAR. In addition, she noted that the proposed standard explains that while the auditor is expected to apply knowledge, judgment and expertise to the matter, the auditor is not expected to have detailed knowledge of laws and regulations beyond that which is required for the audit.</p>
<p>12. Mr. James noted that narrowing the scope to address Ms. Miller’s concern would create a bigger issue given that the scope is the same as that of ISA 250. Mr. Thompson agreed.</p>	<p>Point agreed.</p>
<p>13. Ms. de Beer noted that she found the list of examples of laws and regulations the proposed standard addresses helpful. She suggested that it be made clear that this list is not intended to be exhaustive.</p>	<p>Point not accepted. This is consistent with the current drafting conventions. In addition, if this change were made, it would have to be repeated everywhere else in the Code where lists of examples are provided.</p>
<p>14. Mr. Arteagoitia noted that the EC was supportive of the project. He commented that the proposed standard seemed to be addressing only matters affecting the entity but not consequences beyond the entity.</p>	<p>Support noted. Paragraphs 225.4 and 225.7 make clear that the proposed standard addresses consequences of NOCLAR that go beyond the entity.</p>
<p>DETERMINING WHETHER TO DISCLOSE THE MATTER TO AN APPROPRIATE AUTHORITY</p>	
<p>15. Ms. de Beer was of the view that it would not be sufficient to simply acknowledge that in some jurisdictions there is legal or regulatory</p>	<p>Point considered.</p>

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<p>requirement to report NOCLAR or suspected NOCLAR to an appropriate authority. She was of the view that where there is such a duty to report, the PA must comply with it. Mr. Hansen agreed and suggested that this be included in the list of factors in paragraph 225.28 even if doing so would be repetitive. Mss. Robert and Singh agreed with Ms. de Beer and Mr. Hansen.</p>	<p>The Task Force believes that the duty of the PA to comply with applicable laws and regulations is already clearly set out in paragraph 225.20(a). The PA would already need to have complied with this requirement before reaching the point of determining whether or not to make a disclosure to an appropriate authority. The Task Force notes that this duty is also already specified in paragraph 225.10. The Task Force believes that repeating the requirement a third time would be unnecessary.</p>
<p>16. Mr. Hansen also suggested that the reference to the client’s “license” to operate in the first sub-bullet should be amended to the client’s “ability” to operate.</p>	<p>Point accepted.</p>
<p>17. Mr. Bradbury wondered whether the reference to the client’s license to operate could act as a disincentive for the auditor to report. He suggested that the Task Force consider strengthening the wording.</p>	<p>Ms. Gardner agreed that it should be the matter that should create a threat to the client’s ability to operate and not the disclosure itself. Point considered. The Task Force notes that the reference in paragraph 225.28 is with respect to the matter and not to the disclosure.</p>
<p>18. Ms. Lopez suggested adding “whether the public interest would be better served by disclosing the matter to an appropriate authority” to the list of factors affecting the PA’s decision as to whether to make such a disclosure.</p>	<p>Point not accepted. The Task Force notes that consideration of the public interest is already embedded in paragraph 225.21 through the determination of further action needed to achieve the objectives under the section. It is also in paragraph 225.26 regarding application of the third party test.</p>
<p>19. Mr. Greene wondered what would happen if the PA decided not to disclose.</p>	<p>Ms. Gardner noted that the requirement was for the PA to determine the nature and extent of further action needed. In addition, the PA would be required to document the PA’s thinking process, including the application of the third party test.</p>
<p>20. Ms. Lang expressed support for the list of factors in paragraph 225.28. However, she suggested consideration of better sign-posting given that at the point of considering whether or not to disclose the matter to an appropriate</p>	<p>Point not accepted. The Task Force believes that this could render this part of the proposed standard very granular. Doing so could also lead readers to perceive underlying rules about actions to take in particular</p>

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authority, the PA would have gone through many steps in the process.	circumstances, which is not the intention of the guidance.
21. Ms. McGeachy noted that the proposed standard had come a long way. She suggested that there be a link back in paragraph 225.28 to credible evidence of substantial harm to stakeholders.	Point not accepted. The Task Force believes that this would be unnecessary given that the reference to credible evidence of substantial harm is already included among the factors to consider in paragraph 225.22 re determination of further action needed.
22. Mr. Fukushima noted that at the September 2014 CAG meeting, he had expressed a concern about using the public interest as the threshold for disclosure to an appropriate authority, given the difficulty in ensuring consistent evaluation of that threshold. He expressed support for the revised approach to the threshold.	Support noted.
OTHER COMMENTS ON PROPOSED SECTION 225	
23. In the context of an audit engagement, Mr. Hansen wondered whether every member of the engagement team was intended to have the same responsibility to deal with NOCLAR or suspected NOCLAR. In particular, he felt that it would be challenging for an intern or a junior member of the engagement team to raise the matter directly with management.	Point not accepted. The Code's current drafting convention is to refer to a professional accountant in public practice, which it defines to also mean a firm. To assign specific responsibility within an engagement team would introduce undue complexity. Rather, it is more likely that this matter of process would be addressed by quality control standards such as ISA 220, ³ in particular with respect to engagement performance, direction, supervision and review.
24. With respect to raising the matter with the appropriate level of management, Mr. Hansen noted that there had been a discussion on this process aspect in the IAASB CAG earlier in the week in the context of the IAASB's work stream on ISA 600. ⁴ Accordingly, he suggested that there would be an opportunity for the IESBA to liaise with the IAASB in this regard.	Point noted. IESBA staff to liaise with IAASB staff.

³ ISA 220, *Quality Control for an Audit of Financial Statements*

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

Matters Raised	Task Force Response
<p>25. In relation to PAs in public practice other than auditors, Mr. Hansen noted that it should not be assumed that they may not come across instances of fraud in carrying out their work. He highlighted for example that PAs providing tax services may become aware of tax fraud committed or being committed by their clients.</p>	<p>Point taken into account.</p> <p>The scope is the same across all categories of PAs. See paragraph 225.6.</p>
<p>26. Mr. Ayoub commented that the wording of the last sentence of paragraph 225.14 gave the impression that the PA would decide whether or not to seek legal advice. He felt that if the matter is a NOCLAR or suspected NOCLAR, the PA should consult legal counsel when appropriate and not make legal judgments which the PA may not be qualified to do.</p>	<p>Ms. Gardner noted that different stakeholders have different perspectives on the level of prescription needed. She noted that often the issue can be resolved through discussion with management.</p> <p>Point not accepted. The Task Force notes that nowhere in the Code is the PA obliged to take legal advice.</p>
<p>27. Mr. Ayoub also noted that if a NOCLAR or suspected NOCLAR were to be identified, this may lead to going concern issues for the entity. Accordingly, he suggested the addition of a reference to professional obligations as the PA may find it helpful to bear these in mind in such circumstances.</p>	<p>Point taken into account. This is already addressed in paragraph 225.20(b).</p>
<p>28. With respect to communication of the matter across a network for PAs in public practice other than auditors, Ms. de Beer felt that the wording of the proposed provision would leave too much to judgment. Mr. James agreed, noting that there should be the same requirement to communicate across the network as within the firm.</p>	<p>Ms. Gardner noted that the Task Force had discussed this issue at length and that there are a number of complexities that the PA would need to take into account in determining whether to make the communication.</p> <p>Point considered but not accepted for the reasons set out in the issues paper. The Task Force will explain the rationale in the explanatory memorandum.</p>
<p>29. Mr. Baumann noted that the draft standard had come a long way and that it was going in the right direction. He commented that the approach to escalation of the matter in a group audit context seemed weak. He was of the view that there should be a stronger emphasis that in any circumstances in which a component auditor identifies a NOCLAR or suspected</p>	<p>Ms. Gardner noted that the proposed standard already would require the auditor to comply with professional standards, including communication with the group engagement team in the case of a group audit. Nevertheless, she added that the Task Force would further reflect on the matter.</p> <p>Point not accepted. The Task Force notes that as this is a matter of communication between</p>

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<p>NOCLAR that is deemed important, the matter should be elevated to the group engagement team. He noted that while a matter may be inconsequential at the component level, it may not be so at the group level.</p>	<p>component and group auditors, this should be addressed under ISA 600.</p>
<p>30. Mr. Dalkin noted that there had been significant improvement in the proposed standard and that it had matured. With respect to communication with TCWG, he noted that this is not commonplace in the public sector. Accordingly, he suggested that there be special considerations for public sector auditors in this regard.</p>	<p>Point considered.</p> <p>The Task Force notes that this matter concerns the broader Code and there would be benefit in the Board considering the matter separately as part of a dialogue with INTOSAI.</p>
<p>31. In relation to the documentation requirement, Mr. Fukushima noted that ISAs are focused on obtaining sufficient appropriate audit evidence. He was of the view that certain significant judgments that auditors may make under the proposed NOCLAR standard may be outside the scope of the documentation requirement as specified under the ISAs, and therefore not documented. He suggested that the Task Force reflect on this matter.</p>	<p>Point accepted. The Task Force has included a specific reference to judgments made in the documentation requirement in paragraph 225.33.</p>
<p>PROPOSED SECTION 360</p>	
<p>32. Mr. Michel commented that the proposed standard would be a good step forward for PAs in business (PAIBs) as there has been little communication regarding the importance of ethics to that constituency. He suggested that the Board obtain PAIBs' feedback on the proposals.</p>	<p>Ms. Gardner agreed, noting that the Board had received input from PAIBs at the three global NOCLAR roundtables in 2014. In addition, the Task Force would be consulting with the IFAC PAIB Committee at its upcoming meeting later in March.</p>
<p>33. Ms. de Beer expressed support for the proposed Section 360. She noted that the challenge with respect to PAIBs is implementation and enforcement. She suggested that this may be a matter for the IFAC Compliance Advisory Panel to consider, perhaps through incorporating such</p>	<p>Point noted. The SMOs already address investigation and discipline.</p>

Matters Raised	Task Force Response
<p>considerations in the IFAC Statements of Membership Obligations (SMOs).</p>	
<p>34. Mr. James noted that PAIBs may have legal or regulatory responsibilities to report instances of NOCLAR or suspected NOCLAR that are not significant. He wondered whether there was a way to ensure that they are not discouraged from reporting what they are required by law or regulation to report.</p>	<p>Point considered. The Task Force noted that this matter is already addressed in paragraph 360.10.</p>
<p>35. He also wondered whether under the proposed standard, a PAIB who is a supervisor would be prompted to take appropriate action if the PAIB were to be informed of the matter indirectly as opposed to the PAIB himself or herself coming across it.</p>	<p>Point considered. The Task Force believes that the responsibilities would flow through to the supervisor if the matter were to come to the supervisor's attention through another employee within the organization.</p>
<p>36. Ms. Miller noted that many PAIBs are internal auditors and they may often come across NOCLAR or suspected NOCLAR at suppliers. She wondered whether the scope is really limited to matters identified at the PAIBs' employing organizations or whether this would be left to the PAIBs' judgment.</p>	<p>Point taken into account. NOCLARs that are not committed by the employing organization or by those charged with governance, management or employees of the employing organization are out of scope.</p>
<p>37. Mr. Dalkin commented that the framework schematic was helpful. However, he suggested clarifying it to avoid implying that PAIBs would be required to raise a NOCLAR or suspected NOCLAR to their superior and TCWG at the same time.</p>	<p>Point accepted. Framework schematic adjusted accordingly.</p>
<p>38. With respect to ethics hotlines within government agencies, he noted that allegations that are without merit are a common occurrence. He suggested that there be appropriate considerations in that regard.</p>	<p>Point considered. The Task Force believes that this matter is outside the scope of this project.</p>
<p>39. Mr. Muis noted that legal immunity in a governmental context now often extends to individuals who are not political appointees, for example, treasurers. He wondered how this broadening of legal immunity could be justified.</p>	<p>Point noted. This matter is beyond the scope of this project.</p>

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40. Ms. Robert suggested clarification of the subheadings to make clear which provisions apply to senior PAIBs. She noted, for example, that paragraphs 360.12-13 refer to senior PAIBs but not paragraph 360.14.	Point accepted. Signposting added in paragraph 360.13.
RE-EXPOSURE	
41. Mr. Koksvedgaard inquired as to whether Representatives would support the Board issuing the proposed standard for re-exposure, subject to consideration of the CAG's comments. Messrs. Ayoub, Baumann, Bradbury, Dalkin, Hansen, and Michel, and Mss. Borgerth, de Beer, Elliott, Lopez, McGeachy, Miller, Robert and Singh indicated their support.	Support noted.
42. Mr. Muis noted that the IESBA is a global body and that it is facing many legislators that are unethical. He was of the view that it is challenging to set ethical standards without considering the ethical fabric of laws and regulations. Accordingly, he felt that the rationale for the proposed framework would be important and that the IESBA should maintain pressure on addressing NOCLAR issues at a global level.	Ms. Gardner noted that the Board was indeed doing so through the proposed standard and, in particular, through providing a pathway to disclosure where not already required by law or regulation.
43. Ms. de Beer suggested that the wording of the draft rationale for the framework be reconsidered to avoid it sounding overly defensive in terms of protection of the profession from liability as opposed to the need to acknowledge the realities of the legal and regulatory framework and context.	Point accepted and to be reflected in explanatory memorandum.
WAY FORWARD	
44. Ms. Gardner thanked Representatives for their constructive input, noting that their comments would be duly considered by the Task Force and the Board. As the project was not expected to be on the September 2015 CAG agenda	–

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Matters Raised	Task Force Response
given the timing of the re-ED, Mr. Waldron noted that it would be helpful for a progress report to be provided to the CAG in due course.	