

**Meeting:** IESBA CAG  
**Meeting Location:** New York  
**Meeting Date:** March 11, 2015

# Agenda Item **B**

## Responding to Non-Compliance with Laws and Regulations (NOCLAR)— Report-Back and Issues

### Objectives of Agenda Item

1. To note the report-back on the September 2014 CAG discussion.
2. To obtain CAG Representatives' views on a revised draft of the NOCLAR standard, scheduled for approval for re-exposure at the April 2015 IESBA meeting.
3. To note a draft rationale for the framework to be included in the explanatory memorandum to the re-exposure draft (re-ED).

### Project Status and Timeline

4. At its October 2014 meeting, the IESBA considered the significant feedback received from the three global roundtables on the project held in Hong Kong (May), Brussels (June) and Washington DC (July). The IESBA also considered and broadly supported a proposed framework for responding to NOCLAR or suspected NOCLAR, developed by the Task Force in light of the roundtable input.
5. At its January 2015 meeting, the IESBA considered refinements to the proposed framework and a draft rationale for the framework outlining the strengths of the revised approach to responding to NOCLAR or suspected NOCLAR.
6. At its April 2015 meeting, the IESBA will consider a revised draft of the proposals with a view to approving the re-ED for issuance.
7. The Appendix to this paper provides a project history, including links to the relevant CAG documentation.

### September 2014 CAG Discussion

8. Below are extracts from the minutes of the September 2014 CAG meeting,<sup>1</sup> and an indication of how the project Task Force or IESBA has responded to CAG Representatives' comments.

Matters Raised	Task Force/IESBA Response
REPRESENTATIVES' FEEDBACK ON THE ROUNDTABLES	
Mr. Dalkin reported on his participation in the	For information only, an overview of the range of

<sup>1</sup> The minutes were approved at the November 2014 IESBA CAG teleconference.

Matters Raised	Task Force/IESBA Response
<p>Washington DC roundtable, noting that it would be interesting to see how different the responses were across the three roundtables. He felt that the event was well organized in terms of its format, including the use of breakout groups. In terms of outcomes, he was of the view that there a degree of consistency as some of the groups independently arrived at a number of similar observations.</p>	<p>responses to the roundtable case studies can be accessed <a href="#">here</a>.</p>
<p>Mr. Waldron complimented the Board on the roundtable being very well organized. However, he highlighted the need to reconsider the categorization of the PwC Investor Resource Institute as it is not strictly an investor representative.</p>	<p>Point accepted.</p>
<p>Ms. Blomme shared Mr. Dalkin’s observations, noting that the Brussels roundtable was very well attended by participants from diverse backgrounds and that the breakout sessions were well thought out. She was of the view that the output was diverse and that the report-backs from the breakout sessions had identified a number of broadly consistent messages and take-aways. She added that the issues and discussions were more complex than just how to reconcile the views of the audit profession and those of the regulatory community. She indicated that the discussions were instead more focused on how the profession could make the proposals work. Ms. Lang agreed with Ms. Blomme, noting the high level of participation and the diversity of participants in the Brussels roundtable. She complimented the Board on organizing a successful event, noting that it had helped to raise the profile of the Board and the Code.</p>	<p>Comments noted.</p>
<p>Ms. Molyneux commented that the Brussels roundtable was well planned and run. However, she felt that apart from the initial consensus that doing nothing is not an option, views on the issues were diverse.</p>	<p>While views on the issues were diverse, there was convergence with respect to several key matters as highlighted in the September 2014 CAG agenda material. These include the nature and extent of responsibilities for different categories of professional accountants (PAs), management</p>

Matters Raised	Task Force/IESBA Response
	having primary responsibility for dealing with suspected NOCLAR, and TCWG taking their oversight responsibility very seriously in the vast majority of cases.
<p>Mr. James noted that he was impressed not only with the diversity of the participants in the Washington DC roundtable but also with their seniority. He wondered whether there was a way for the Board to tap into this pool of senior individuals and their organizations as potential members of the CAG or to contribute perspectives on other projects. Mr. Koktvedgaard noted the need to recognize that assembling this group of influential participants had required significant effort but he agreed that there was a question of how best to leverage the experience and expertise within this audience.</p>	<p>Point accepted. The Board will consider leveraging the experience and contacts gained in the roundtables for future projects or initiatives.</p>
<p>SUMMARY OF ROUNDTABLE FEEDBACK AND TASK FORCE PROPOSALS</p>	
<p>Ms. Diplock congratulated the Board on the roundtables initiative and said it was a very good idea, but was disappointed that the weight of the reported outcomes seemed to favor the protection of the interests of the profession over that of the interests of investors and users. She wondered why that was. She asked whether the roundtables had a lot of people from the profession even if they currently worked outside it, and therefore were not recorded as practitioners. She noted the complexity of the matter and addressed the expectation of investors that there would be a duty to report criminal acts, and wondered how the "permission" concept would work. This could be a baseline expectation.</p>	<p>Ms. Gardner noted in relation to the representation at the roundtables that it was almost inevitable that the event would attract a fair number of accountants and lawyers given the roles the Board was aiming to bring to the table, and that the overall representation at the roundtables should be considered in that context.</p>
<p>Ms. Diplock also noted that in her experience, global standards are very difficult to set. She acknowledged that in some jurisdictions there may be unintended consequences when setting such standards. However, she was of the view that this should not mean that the Board should not set standards to which jurisdictions should aspire.</p>	<p>The Board strongly believes in setting robust principles-based standards that are operable on a global basis.</p>

Matters Raised	Task Force/IESBA Response
<p>She warned against a “lowest common denominator” approach.</p>	
<p>Mr. Dalkin commented that the view within his breakout group in the Washington DC roundtable was that the focus should be closer to financial statement audits. He noted that as the focus moves further away from laws and regulations relating to financial statements, the greater the practical issues. Noting as an example that the Dodd-Frank Act in the U.S. is quite a substantial piece of legislation, he observed that many auditors are not lawyers. Accordingly, there was a fair amount of discussion in his breakout group about the practical issues. He also noted discussion in his group about the practical challenges arising from differences in legal frameworks across jurisdictions.</p>	<p>Points taken into account. The Task Force has endeavored to develop a framework for responding to suspected NOCLAR that will not only be proportional but also practical in terms of guiding PAs in responding appropriately in such a situation.</p>
<p>Mr. Ahmed noted his view that based on feedback he had received from those who attended the Hong Kong roundtable, the Board had achieved high quality outputs from the roundtables. He also noted that many of those he had spoken to in his region were looking for a stronger recommendation than the current proposals. He felt that NOCLAR issues were central to the global financial crisis, noting that these reflect a deeper problem in that accountants, particularly in banks, who reported concerns about dubious transactions were not listened to seriously by management or charged with governance. He noted that a number of jurisdictions in Asia that would be looking to taking up the Code would have preferred a stronger recommendation.</p>	<p>Point taken into account. As explained in Agenda Item B-3, the proposed response framework represents a robust approach to addressing NOCLAR or suspected NOCLAR.</p>
<p>Mr. Ahmed also noted that from the Islamic Finance perspective, ethics comes in at two different levels. First, a general requirement for a high level of ethical conduct for everyone. And secondly, in addition to the regular internal and external audit functions, a bank must have a Sharia advisory board which carries out internal audits of compliance with ethical requirements.</p>	<p>Comments noted.</p>

Matters Raised	Task Force/IESBA Response
<p>Mr. Hansen noted that he did not hear participants at the Washington DC roundtable who were advocating a requirement in the Code for an auditor to report NOCLAR to an appropriate authority. Rather, what he heard from representatives from the firms was a commitment to endeavor to look for a practicable way forward. He agreed that firms should not be expected to be the police. However, he was of the view that they have a responsibility to the public, especially in the area of financial reporting, particularly fraud. He noted that there was discussion in his breakout group regarding the approach taken in Regulation 10A under securities regulation in the U.S. that embeds escalation to provide management with every opportunity to do the right thing. However, he noted his difficulty understanding why professional accountants (PAs) with a trust link to the public and licensed to perform an exclusive role in society would not have a responsibility to say something when it is not right.</p>	<p>Points taken into account. The proposed response framework is intended to guide PAs in determining the need for further action in the public interest, including whether to disclose the matter to an appropriate authority.</p>
<p>Ms. Molyneux noted that it was clear in the Brussels roundtable that there was no question that something has to be done. She felt that participants in that roundtable were heavily from the profession. She also reflected on her wider experience as a corporate director in that in some jurisdictions, those charged with governance are criminally liable for not providing appropriate guidance under occupational health and safety laws and regulations, such as ensuring that site workers are provided with protective helmets. She suggested that this type of more difficult issues should be brought into the debate in order to arrive at an end result that something must be done.</p>	<p>Point taken into account. The proposed response framework is intended to guide PAs in making the appropriate judgments when facing a suspected NOCLAR, including consideration of whether it has or may cause substantial harm to stakeholders.</p>
<p>Noting that she has not had an opportunity to discuss the issues within the Basel Committee on Banking Supervision (BCBS), Ms. Sucher was of the view that the perspectives of most BCBS representatives would be closer to an expectation of a duty to report for the PA. She noted that one</p>	<p>Ms. Gardner noted that the Task Force is well aware that major jurisdictions already require auditors to report suspected NOCLAR to an appropriate authority, mostly for public interest entities (PIEs) or listed entities, and that this should cover most of the issues one should be concerned about. She agreed</p>

Matters Raised	Task Force/IESBA Response
<p>of the reasons the BCBS has not been involved in the debate so far is that in most jurisdictions, there is already a requirement for auditors to report certain matters to banking supervisors. She added that in most jurisdictions, there is a legal or regulatory framework in place for that, with a safe harbor for the auditor and reasonably clear articulation of what is covered by the duty to report. She also noted that before the global financial crisis, most banking supervisors would agree that there had been little to no reports of such matters being made despite some evidence that such reports should have been made. Accordingly, she felt that there is a mindset issue in that even if a legal framework is in place, auditors and PAIBs are not reporting under it for a variety of reasons. So she wondered whether there should be a broader look at the mindset issue as she was not convinced that words alone would lead to an improved outcome. However, she felt that more definitive words would help in setting the tone.</p>	<p>that the question should be more what the Code can do to increase the likelihood of the right thing being done rather than simply providing more rules. She noted that much time had been spent focusing on whether there should be a requirement to disclose whereas the original objective of the project was how to ensure that PAs in different roles do the right thing when they come across suspected NOCLAR.</p> <p>Point taken into account by the Task Force. The proposed response framework is intended to stimulate a greater incidence of reporting of NOCLAR or suspected NOCLAR by PAs. In particular, PAs would be obliged to understand the applicable laws and regulations when facing NOCLAR/suspected NOCLAR and comply with them.</p>
<p>Ms. Sucher acknowledged the intention to make the proposed standard more reasonable and practicable by narrowing its scope. However, she questioned the appropriateness of doing so if the intention was to also remove the duty to report suspected NOCLAR to an appropriate authority.</p>	<p>Ms. Gardner noted that the Task Force was really focusing on both narrowing the scope and raising the bar in terms of the expectation of the PA.</p>
<p>Noting the reference to the minority view in support of a requirement to report in the presentation, Mr. James emphasized the need to carefully categorize this minority view and understanding what those in that minority said.</p>	<p>Point accepted. The summary of roundtable input presented to the Board in October 2014 no longer made such a reference.</p>
<p>He concurred with some of Ms. Sucher's comments, noting that while PAs cannot be expected to know about all laws and regulations, it would be difficult to understand why they should not report a suspected NOCLAR in the public interest if management has not done the right thing.</p>	<p>See responses to Ms. Sucher's comments above.</p>

Matters Raised	Task Force/IESBA Response
SCOPE AND OBJECTIVES	
<p>Ms. Ceynowa cautioned against using the term “assisting management” in the objectives as this would raise independence issues. She suggested that a different term be used. Ms. Blomme and Mr. Dalkin agreed.</p>	<p>Point accepted and objectives reworded.</p>
<p>Commenting in a personal capacity, Mr. Fukushima noted a perceived inconsistency between the objectives and the scope of the revised framework. He expressed skepticism about narrowing the scope of the proposals, noting that ISA 250<sup>2</sup> was designed to assist auditors in identifying material misstatements in the financial statements whereas the objectives of the proposals appear to be broader in scope. Based on discussions with some of his counterparts on IOSCO, he was of the view that the Code should address broader categories of NOCLAR that would significantly impact the public, such as bribery, money laundering and terrorist financing.</p>	<p>Ms. Gardner explained that these types of issues would be covered under the second category of laws and regulations in the proposed scope.</p> <p>Point taken into account. See discussion of Issue A below.</p>
<p>Ms. Sucher noted that she was unsure whether the examples of issues highlighted by Mr. Fukushima would all be covered under the second category of laws and regulations in the scope but she welcomed the Task Force’s intention to go beyond audits of financial statements. She cautioned that transposing elements from another category of standards may have an unintended consequence of missing out coverage of certain matters that should be addressed. She encouraged the Task Force to further reflect on this.</p>	<p>Suggestion taken into account. See discussion of Issue A below.</p>
<p>Ms. Blomme felt that the meaning of the term “avert” in the proposed objectives was unclear. She also commented that the proposed scope seemed to be all related to financial statements and wondered what this would mean for a PA</p>	<p>Points taken into account. The Task Force has refined the wording of the objectives and clarified the scope of the standard. See Agenda Item B-1.</p>

<sup>2</sup> ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*

Matters Raised	Task Force/IESBA Response
<p>specializing in VAT matters. She suggested considering how such a situation would be dealt with under the revised approach. Ms. Sucher agreed with Ms. Blomme, noting that the scope appeared somewhat narrow given the different roles PAs can play.</p>	
<p>Mr. Dalkin felt that the phrase “to seek to avert” would give rise to an independence issue in the case of an external audit and that it would be better to use the term “to report” as this would not be participating with management.</p>	<p>Ms. Gardner explained that the Task Force’s intention was to convey the concept of deterrence in that part of the objectives rather than what the response should be.</p> <p>Point accepted by the Task Force. Objectives reworded.</p>
<p>Ms. Molyneux drew attention to some of the discussions within the Organization for Economic Cooperation and Development (OECD) when it was developing its anti-bribery convention. She suggested that some of the OECD’s thinking in that regard may assist the Board as it considers the challenge of how to make the proposals operable across borders.</p>	<p>Suggestion noted. The Task Force believes that the revised proposals embodied in the response framework will be operable across borders.</p>
<p>Mr. James suggested that the objectives make reference to the public interest to help set the appropriate tone and mindset for PAs under the standard. Mr. Hansen and Ms. Gardner agreed.</p>	<p>Point accepted. See paragraph 225.3 of Agenda Item B-1.</p>
<p>Ms. Ceynowa noted that the concept of prevention and detection is more a management responsibility. She added that under Regulation 10A in the U.S., auditors have a role to play when non-compliance has occurred, not so much in preventing NOCLAR.</p>	<p>Point noted.</p>
<p>Expressing a personal view, Ms. Diplock felt that the first part of the objectives is essential. She was of the view that the second and third parts were more about what management does and not what auditors do themselves. She felt that the emphasis on the latter two parts was somewhat unbalanced. She suggested that the approach should be more about what auditors should do when they stumble across a NOCLAR.</p>	<p>Point taken into account. The Task Force believes that the proposed response framework represents a balanced approach, as explained in the draft rationale for the framework (Agenda Item B-3).</p>

Matters Raised	Task Force/IESBA Response
REQUIRED RESPONSES FOR AUDITORS	
<p>Mr. Fukushima felt that the threshold of “other than clearly inconsequential” was subjective and that while ISA 250 might use it, this was in the context of audits of financial statements and the materiality levels as determined for the audit. He was of the view that the Code should deal with broader matters. He added that it was unclear what the denominator should be as a reference point for “inconsequential.” In relation to the options for further action, he expressed a concern about the suggestion of withdrawal from the engagement and the client relationship. He felt that withdrawal should not be an alternative to disclosure. Regarding the suggestion of informing the parent entity of the suspected NOCLAR in a component within a group, he noted that the parent entity may be unable to assess the impact of the NOCLAR if the component is based in another jurisdiction. Finally, he felt that the scope of the proposals should be broader than the scope of ISA 250.</p>	<p>Points taken into account. The Task Force has, in particular, clarified the scope of the standard as well as the intention regarding the threshold of “clearly inconsequential.” See Issues A and B below.</p>
<p>He was of the view that if the auditor identifies a suspected NOCLAR that may lead to material misstatement of the financial statements and management has not appropriately addressed the matter, the auditor should report the matter to an appropriate authority.</p>	<p>Point taken into account. See draft rationale for the framework, which outlines the strengths of the revised approach to responding to NOCLAR or suspected NOCLAR (Agenda Item B-3).</p>
<p>Mr. Dalkin commented that from a U.S. perspective, a threshold of other than clearly inconsequential is a very low bar. He was of the view that a higher threshold would be needed, such as direct and material consequence. Mr. Waldron expressed support for a low threshold in this case on the grounds that if something is potentially illegal, such a threshold would resonate with those who have to deal with the non-compliance.</p>	<p>Points taken into account. The approach to the threshold of “clearly inconsequential” has been amended. See further discussion below and also paragraph 225.8(a) in Agenda Item B-1.</p>
<p>Mr. Waldron noted that the reference to the status of the entity as a PIE/listed entity in the list of</p>	<p>Points accepted. This bullet point has now been</p>

Matters Raised	Task Force/IESBA Response
<p>factors on which to base the determination of further action appeared to unduly narrow the scope. He was of the view that the scope should encompass non-PIEs equally. Mr. Hansen and Ms. de Beer also questioned filtering at the PIE level as they felt that the same ethical principles should apply with respect to all entities. Mr. Hansen also noted that PAs provide many non-audit services to clients that are not PIEs and that these have external stakeholders such as creditors.</p>	<p>deleted from the list of factors to consider.</p>
<p>Mr. Waldron also wondered whether the requirement to discuss the matter with those charged with governance should be given greater prominence given the importance of independent audit committees to the process.</p>	<p>Point taken into account. Under ISAs 250<sup>3</sup> and 260,<sup>4</sup> auditors will already be obliged to discuss the matter with TCWG.</p>
<p>Referring to the various references to management and those charged with governance in the proposed framework, Mr. Hansen noted that there is a distinction between those charged with governance who are independent of management and those who are not. He was of the view that this distinction is important when dealing with an independent board of directors.</p>	<p>Point accepted. See paragraph 225.16 of Agenda Item B-1.</p>
<p>Mr. Bluhm expressed support for the proposed revised framework from an auditor’s perspective. Regarding the threshold of “other than clearly inconsequential,” he was of the view that auditors would have an appreciation of what is intended but he acknowledged the need for guidance around this concept.</p>	<p>Support noted and point taken into account. See paragraph 225.8(a) in in Agenda Item B-1.</p>
<p>Regarding the options for further action, he did not perceive them as being mutually exclusive. So he did not share the view that these could allow the auditor to turn a blind eye to the matter. He suggested that this be made clear.</p>	<p>Point noted. The options for further action are not intended to be mutually exclusive.</p>

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

<sup>4</sup> ISA 260, *Communication with Those Charged with Governance*

Matters Raised	Task Force/IESBA Response
<p>Regarding the proposed third party test, Mr. Bluhm was of the view that this can be effective and powerful if properly done. Ms. Sucher agreed, noting that in her experience the third party test can be very helpful in bringing an objective perspective to the issue as opposed to an internal view of it. Ms. Lopez was of the view that in applying the third party test, the auditor should ask whether the public interest has been served.</p>	<p>Support noted.</p>
<p>Ms. Diplock suggested that the list of options for further action should also include a reference to the public interest.</p>	<p>The reference to the public interest is already an integral part of the objectives.</p>
<p>Referring to the option of withdrawing from the client relationship, Mr. Hansen highlighted a suggestion at the Washington DC roundtable about achieving the desired outcome through a “noisy” withdrawal. He disagreed with this suggestion as he felt that the issue is about having the courage to do the right thing. He was of the view that a noisy withdrawal could simply lead to the issue being perpetuated with the new firm. Ms. Sucher was of the view that withdrawing from the client relationship and saying nothing would be of no use to anyone. She felt that as in the UK there should a framework in place for auditors to explain why they have withdrawn from the client relationship. Ms. Lopez was of the view that auditors should not simply stop at the withdrawal stage but that they should consider the need for further steps beyond that.</p>	<p>Point taken into account. The revised proposals will require communication between an existing auditor and a proposed auditor.</p> <p>In addition, the proposed response framework will require the auditor to determine the need for further action. This may include, but would not be limited to, withdrawal from the engagement and the client relationship.</p>
<p>With regard to the statement in the proposed framework that sometimes there may be no effective solution to the issue, Mr. Hansen felt that the standard should avoid making such a statement. Ms. Lopez and Mr. Ahmed agreed.</p>	<p>Point accepted. Statement now deleted.</p>
<p>Mr. Hansen did not believe that the guidance on taking legal advice or consulting with a professional body would contribute much to the standard as PAs know that they can always do so. He expressed a concern about issuing a</p>	<p>Point not accepted. The Task Force does not believe that it would be appropriate to underplay the importance of legal advice when dealing with a complex topic such as NOCLAR.</p>

Matters Raised	Task Force/IESBA Response
document with guidance that would provide lots of opportunity for rationalization rather than setting out clearly what should be the responsibility for the public interest.	
Ms. Lang commented that PAs in the different roles need a workable standard as this would be in the public interest. She was of the view that the proposed framework was clear and comprehensive, adding that the outcomes from the roundtables demonstrated that the issue of NOCLAR is multi-layered. She noted that changing mindset requires education. She was of the view that there would be benefit in considering how to bring in the context of education in the longer term, which would also be in the public interest. Ms. Blomme agreed, noting that it is very much about the mindset and changing behavior.	Support noted and point agreed. Addressing NOCLARs comprehensively requires a holistic approach. This means the involvement of others in the financial architecture who have a role to play, including management, TCWG, regulators, and educators.
Ms. Borgerth commented that the discussion highlights that the topic of NOCLAR requires evolving thinking to develop a solution that can be applied on a global scale. As a professor, she agreed with Ms. Lang’s observations about the importance of education. She suggested that aspiring PAs should be taught how to work from an ethical platform.	Ditto.
Mr. James wondered whether the list of factors to consider in determining the nature and extent of further action is intended to be comprehensive. He felt that there could be other factors to consider, including the seniority of the individual and the pervasiveness of the issue throughout the organization. With regard to documentation, he felt that there should be clarity as to what should be documented.	Points taken into account. The list of factors is not intended to be comprehensive. See paragraph 225.22 of Agenda Item B-1.  See paragraphs 225.32-33 of Agenda Item B-1 re documentation.
Finally, he wondered how the views from the roundtables and the CAG would be weighed by the Board, particularly when those views are in conflict with each other.	The Board weighs the views of stakeholders based on their merits and not on numerical count.
Mr. Ahmed noted that in the aftermath of the	Support and comments noted.

Matters Raised	Task Force/IESBA Response
<p>global financial crisis, there has been a significant change in public expectations. He therefore felt that the topic of NOCLAR is of high importance and he commended the Board on addressing it. Given the change in public expectations, he was of the view that PAs should be prepared, but not necessarily required, to act as whistle-blowers. In this regard, he expressed strong support for the proposed framework, noting that the underlying concepts and process seemed clear and well thought out. He added that the proposed approach conveyed a sense of familiarity in terms of what auditors would be expected to do when they identify material misstatement in a bank audit.</p>	
<p>Ms. Blomme was of the view that the proposed framework would be workable from the perspective of the EU. However, she wondered why the proposed framework should not be an extension of ISA 250. She encouraged the IAASB to consider this.</p>	<p>Mr. Gunn acknowledged the suggestion, noting that there had been ongoing liaison on the project between the IESBA and the IAASB, both at the leadership level and at the staff level. He noted that this dialogue would continue, adding that it would be important not to unwind what are clear obligations for auditors in an audit of financial statements.</p>
<p>Ms. de Beer expressed support for the notion of a framework for auditors. However, she wondered whether this framework would be sufficiently clear and robust to lead the auditor to the right answer. Accordingly, she suggested that the proposed framework be tested through a real case.</p>	<p>Support noted and point taken into account.</p> <p>It would not be practicable to test the framework through a real case given the lack of access to the numerous judgments and decisions that would have been made. However, the Task Force has developed an illustrative example showing the application of the framework – see Agenda Item B-4.</p>
<p>REQUIRED RESPONSES FOR SENIOR PAIBS</p>	
<p>Ms. Diplock commented that as well as setting up the framework, it was unclear whether the proposed changes to Section 300 would address the question of whether PAIBs are complying with the Code. She felt it important to ensure that compliance with the Code is embedded in the organization.</p>	<p>Point noted. This goes to the importance of a holistic approach to address NOCLAR on a comprehensive basis. Ensuring PAIBs' compliance with the Code requires the involvement of IFAC member bodies on the enforcement side. Embedding compliance with the Code within the organization requires the involvement of management and TCWG.</p>
<p>Ms. Lang suggested that the Board liaise with the</p>	<p>Point accepted. A member of the Task Force will</p>

Matters Raised	Task Force/IESBA Response
<p>IFAC PAIB Committee to obtain its support for the proposed revised framework.</p>	<p>attend the IFAC PAIB Committee on March 23, 2015 in Brussels and present the proposed NOCLAR framework.</p>
<p>Mr. Koktvedgaard agreed that achieving the right tone at the top is the right thing to do, noting that the emphasis should be not only on rectifying or remediating the issue but also on preventing NOCLAR.</p>	<p>Point agreed. Changes have been proposed to Section 300 under the Part C Phase I ED to emphasize the importance of the tone at the top and of prevention of NOCLAR (paragraph 300.5 of the ED).</p>
<p>Ms. Blomme observed that the proposed framework may be much harder for PAIBs to apply than PAs in public practice as the latter may lose one client but the former may lose their livelihoods entirely. She noted that PAIBs will very often be forced to leave their employing organizations. She wondered whether sufficient consideration had been given to the potentially very serious consequences for them.</p>	<p>Ms. Gardner noted that this had been discussed within the Task Force and that there would be appropriate conditions such as the availability of legal protection. However, she noted the Task Force view that there should be higher expectations for senior PAIBs such as CFOs given their roles and positions within the entity.</p>
<p>Mr. Koktvedgaard highlighted Ms. Manabat's offline comments that there is an expectation for such individuals but the question was how far this should be taken.</p>	<p>Point taken into account. The proposed response framework is designed to be proportional, taking into account the seniority of the PAIB and his or her sphere of influence.</p>
<p>Mr. Waldron noted that his comments with respect to auditors applied also with respect to senior PAIBs.</p>	<p>Point taken into account.</p>
<p>REQUIRED RESPONSES FOR OTHER PAs IN PUBLIC PRACTICE</p>	
<p>Mr. Thompson noted that many firms employ lawyers in the provision of tax services. He wondered whether these individuals would be covered by the proposed standard.</p>	<p>Point considered. Given that the definition of a professional accountant in public practice under the Code includes firms, lawyers employed by a firm in the provision of services to clients would be scoped in. However, the latest draft of the NOCLAR standard is more responsive to the challenges that PAs in those firms may face when performing roles other than as members of an audit team (see paragraph 225.45 of Agenda Item B-1).</p>
<p>Ms. Lang commented that the proposed approach for PAs in public practice other than auditors appeared to be a reasonable one. However, she indicated that she would like to test it within her</p>	<p>Point noted.</p>

Matters Raised	Task Force/IESBA Response
organization.	

**Matters for Consideration**

9. Based on the January 2015 IESBA discussion, the Task Force has fine-tuned the framework as shown in Agenda Item B-2. The Task Force has also made consequential and other refinements to the draft text as shown in Agenda Item B-1. The significant and other matters on which the Task Force wishes to seek CAG input are set out below. These are outlined in relation to proposed Section 225;<sup>5</sup> corresponding changes have been made to proposed Section 360.<sup>6</sup>
  - A. SCOPE OF PROPOSED SECTION 225
10. As noted above, at the September 2014 CAG meeting some Representatives had wondered whether the proposed scope would be sufficiently broad to capture NOCLARs that do not directly impact the financial statements, particularly in the case of PAs in public practice other than auditors and PAIBs. It was also noted that care should be taken in that transposing elements from another category of standards (i.e., in this case aligning the scope with that in ISA 250) may have an unintended consequence of missing out coverage of certain matters that should be addressed.
11. In the light of these comments, the Task Force has reconsidered the description of the scope in Section 225. The Task Force believes that the two categories of laws and regulations covered by ISA 250 continue to be appropriate for purposes of the section, i.e.:
  - (a) Laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the client’s financial statements; and
  - (b) Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the 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.
12. The Task Force, however, has made changes to the text to more clearly explain the nature of the NOCLARs envisaged to be covered by the section, and how its scope articulates with that of ISA 250:
  - Providing a list of examples covering both categories of laws and regulations above (see paragraph 225.6).<sup>7</sup>
  - Explaining that while non-compliance with the two categories of laws and regulations may result in fines, litigation or other consequences for the client that may have a material effect on its financial statements (i.e. the focus of ISA 250), it may, importantly, have wider public interest implications in terms of potentially substantial harm to the client and stakeholders (which is where the Code needs to go beyond ISA 250). (See paragraph 225.7.)

<sup>5</sup> Proposed Section 225, *Responding to Non-Compliance or Suspected Non-Compliance with Laws and Regulations*

<sup>6</sup> Proposed Section 360, *Responding to Non-Compliance or Suspected Non-Compliance with Laws and Regulations*

<sup>7</sup> Paragraph numbers refer to Agenda Item B-1 unless otherwise stated.

- Providing examples of non-compliance in the two categories of laws and regulations. (See paragraph 225.7.)
13. The Task Force believes these changes, which the Board has supported, present the scope of the section more clearly and coherently, and are responsive to the advice received from the CAG.

**Matter for CAG Consideration**

1. Do Representatives agree with the Task Force's proposals?

B. "CLEARLY INCONSEQUENTIAL" THRESHOLD

14. The Task Force had proposed to require that if the PA becomes aware of information concerning suspected NOCLAR and the matter is other than clearly inconsequential, the PA obtain an understanding of the matter. At the October 2014 meeting, a few IESBA members questioned how that threshold would articulate with the scope of ISA 250. It was noted that the thresholds implicit in the description of the two categories of laws and regulation within the latter (i.e., "material amounts and disclosures" and "fundamental to the operating aspects of the business") appeared to already be significantly higher than clearly inconsequential. In addition, it was felt that the threshold of clearly inconsequential was too low and that tied to the very first requirement in the process, it could prompt the PA to seek legal advice in almost every case.
15. The Task Force has reflected on these comments and believes that the perception about the threshold being very low may have arisen because it was directly linked to the requirement to obtain an understanding of the matter, particularly as that requirement included obtaining an understanding of the potential consequences to the client and stakeholders. Rather, the Task Force believes that at the point of coming across information concerning an instance of non-compliance or suspected non-compliance, the PA would not be in a position to assess the potential consequences of the matter without *first* having obtained an understanding of it. Accordingly, other than when the matter is *clearly* inconsequential, the PA ought to obtain that understanding to be able to make an assessment of those consequences.
16. Therefore, to make this clearer and to address the concerns noted above (which echoed similar concerns at the roundtables), the Task Force proposes the following changes, which the Board has supported:
- Removing the threshold from the requirement to obtain an understanding of the matter (see paragraph 225.11); and
  - Scoping out matters that are clearly inconsequential from the section and including guidance to explain when a matter would be considered clearly inconsequential (see paragraph 225.8(a)).
17. As a result of these changes, the articulation of the requirement to obtain an understanding of the matter is now largely consistent with how the corresponding requirement in ISA 250 is worded. The PA's understanding and assessment of the potential consequences would then be developed through the ensuing discussion with management and, where appropriate, TCWG, assuming the PA suspects that non-compliance has occurred or may be about to occur (see paragraphs 225.12-14).

**Matter for CAG Consideration**

2. Do Representatives agree with the Task Force's proposals?

C. PROFESSIONAL ACCOUNTANTS IN PUBLIC PRACTICE PROVIDING SERVICES OTHER THAN AUDITS OF FINANCIAL STATEMENTS

18. The Task Force had proposed that if a PA performing a non-audit service for an audit client of the firm or a network firm suspects that non-compliance has been or may be committed, the PA consider informing the engagement partner for the audit about the matter. The Task Force reflected on the need for further guidance in relation to when such communication would be appropriate. The Task Force noted that there should generally be no impediments to reporting within a firm. The situation may, however, be more complex and nuanced when it comes to reporting to another firm in the network. For example, there may be local laws or regulations that prevent disclosure outside the jurisdiction; the nature of the engagement itself may limit disclosure, such as in the case of forensic services performed under legal privilege or in an ongoing investigation into the matter by a prosecutor; and materiality considerations may come into play (e.g., the matter may be immaterial to the audit of the group).
19. The Task Force felt that addressing all the potential complexities of reporting to another network firm would lead to the guidance becoming unbalanced and skewed towards this particular aspect of the proposals, detracting from the broader principles the Board would be seeking to establish. The Task Force believes that network firms will generally be able to judge the appropriate course of action with respect to reporting out to another network firm, taking into account the circumstances of the matter and the local jurisdictional context. Accordingly, the Task Force has proposed that the PA *consider* whether to communicate the matter to the network firm so as to enable the engagement partner for the audit to be informed about it (see paragraph 225.41). The Task Force has also proposed guidance regarding factors to consider in assessing whether information can be disclosed outside the entity (see paragraph 225.45).
20. The Task Force has, however, made it clear that where the client is an audit client of the firm, the expectation would be that the PA would communicate the matter within the firm to enable the audit engagement partner to be informed about it. Accordingly, the Task Force has proposed that the PA be required to do so (see paragraph 225.40).

**Matter for CAG Consideration**

3. Do Representatives agree with the Task Force's proposals?

D. OTHER ENHANCEMENTS TO THE PROPOSED SECTION 225

21. The Task Force has made a number of other enhancements to Section 225, including the following:
- Referring to non-compliance or suspected non-compliance with laws and regulations in the title of the section and throughout the section where appropriate, consistent with ISA 250. This recognizes that the evidence may be beyond doubt that non-compliance has occurred, notwithstanding that it would be up to a court of law to ultimately determine whether the act constitutes actual non-compliance.

- More clearly setting out upfront the purpose of the section, i.e., to *guide* the PA in assessing the implications of NOCLAR or suspected NOCLAR and the possible courses of action in responding to it (see paragraph 225.1).
- Making it clear that what constitutes the public interest will depend on the facts and circumstances of the NOCLAR or suspected NOCLAR, and the nature and extent of the consequences to stakeholders (see paragraph 225.4).
- Guidance regarding the concept of “substantial harm” (see paragraph 225.22, last bullet).
- A requirement for the PA to *understand* the provisions of laws and regulations governing how NOCLAR or suspected NOCLAR should be addressed, and not merely to comply with them (see paragraph 225.10).
- Rebalancing the list of factors to consider in determining whether to disclose the matter to an appropriate authority (see paragraph 225.28.)
- Recognizing that in some jurisdictions there may be limitations as to the further actions available to the PA and withdrawal may be the only available course of action (see paragraph 225.31).
- Emphasizing the requirement for documentation under the ISAs, including the specific matters to be documented (see paragraphs 225.32-33).

#### **Matters for CAG Consideration**

4. Do Representatives have views on any of the above enhancements to the text?

#### **E. DRAFT RATIONALE FOR FRAMEWORK**

22. In anticipation of the Board approving the revised text of the NOCLAR standard for re-exposure at its April 2015 meeting, the Task Force has developed a draft rationale for the framework which will be incorporated into the explanatory memorandum to the re-ED. The draft rationale explains the strengths of the framework and why the Task Force believes it will result in better public interest outcomes. This rationale has been supported by the Board. For information, it is included in Agenda Item B-3.
23. Also for purposes of inclusion in the explanatory memorandum, the Board has asked the Task Force to develop a flow chart to illustrate the pathways that could be taken in responding to NOCLAR or suspected NOCLAR. An illustrative case has been provided to show how the framework could be applied in practice. For information, this is included in Agenda Item B-4.

#### **Material Presented – CAG Papers**

Agenda Item B-1	Draft NOCLAR Re-ED
Agenda Item B-2	Proposed NOCLAR Response Framework
Agenda Item B-3	Draft Rationale for Framework
Agenda Item B-4	Illustrative Example and Flow Chart

**Project History**

**Project: Responding to Non-Compliance or Suspected Non-Compliance with Laws and Regulations**

**Summary**

	<b>CAG Meeting</b>	<b>IESBA Meeting</b>
Project commencement	March 2010 September 2010	October 2009 November 2010
Development of proposed international pronouncement (up to exposure)	March 2011 September 2011 March 2012	February 2011 June 2011 October 2011 February 2012 April 2012 June 2012
Exposure	August 2012 – December 2012	
Consideration of respondents' comments on exposure and development of revised proposals	April 2013 September 2013	March 2013 June 2013 September 2013 December 2013
Consideration of tentative revised proposals	March 2014	–
Updates regarding NOCLAR roundtables	–	April 2014 July 2014
Consideration of input received from roundtables and proposed NOCLAR response framework	September 2014	September 2014
Consideration of refinements to proposed framework	January 2015	–

**CAG Discussions: Detailed References**

<p><b>Project Commencement</b></p>	<p><u>March 2010</u>          See IESBA CAG meeting material <a href="#">here</a> and CAG meeting <a href="#">minutes</a> (section C).  <u>September 2010</u>          See IESBA CAG meeting <a href="#">material</a> and CAG meeting <a href="#">minutes</a> (section C).</p>
<p><b>Development of Proposed International Pronouncement (Up to Exposure)</b></p>	<p><u>March 2011</u>          See IESBA CAG meeting <a href="#">material</a> and CAG meeting <a href="#">minutes</a> (section D).  <u>September 2011</u>          See IESBA CAG meeting <a href="#">material</a> and CAG meeting <a href="#">minutes</a> (section C).  <u>March 2012</u>          See IESBA CAG meeting <a href="#">material</a> and CAG meeting <a href="#">minutes</a> (section D).</p>
<p><b>Consideration of Respondents' Comments and Development of Revised Proposals</b></p>	<p><u>April 2013</u>          See IESBA CAG meeting <a href="#">material</a> and CAG meeting <a href="#">minutes</a> (section B).          See <a href="#">report back</a> on April 2013 discussion.  <u>September 2013</u>          See IESBA CAG meeting <a href="#">material</a> and CAG meeting <a href="#">minutes</a> (section F).          See <a href="#">report back</a> on September 2013 discussion.  <u>March 2014</u>          See IESBA CAG meeting <a href="#">material</a> and CAG meeting <a href="#">minutes</a> (section B).          See <a href="#">report-back</a> on March 2014 discussion.  <u>September 2014</u>          See IESBA CAG meeting <a href="#">material</a> and <a href="#">CAG meeting minutes</a> (section E).          See report back on September 2014 discussion in this agenda paper.</p>