RESPONDING TO NON-COMPLIANCE OR SUSPECTED NON-COMPLIANCE WITH LAWS AND REGULATIONS (NOCLAR)—ISSUES AND WORKING GROUP RECOMMENDATIONS

Summary of the IAASB’s Discussions at Its March 2015 Meeting

Ms. Caroline Gardner, IESBA member and Chair of the NOCLAR Task Force, updated the IAASB on the IESBA’s progress towards a re-exposure draft (re-ED) of the proposed changes to the IESBA Code to address actions by professional accountants in the case of actual or suspected non-compliance with laws and regulations. She highlighted that the NOCLAR project was a top priority for IESBA and that the ED was planned for approval in April 2015. Mr. Murtagh explained that an IAASB Working Group was proposed to be established to consider the need for any amendments to the IAASB’s International Standards to ensure there are no conflicts with the proposed revised IESBA Code and the timing of such amendments.

The IAASB supported the establishment of the Working Group and asked the Working Group to consider the following:

- Whether the amendments would be limited to changes to avoid inconsistencies between the IAASB’s International Standards and the proposed revised IESBA Code, or whether the proposed revised IESBA Code indicates areas of the International Standards that may warrant additional scrutiny. It was noted that changes beyond the minimum to avoid inconsistencies may need to be considered as part of the IAASB’s next work plan, whereas the initial intent would be to progress the amendments quickly to enable an IAASB ED to be exposed for comment concurrently with the NOCLAR re-ED.
- The impact on the professional accountant’s proposed ability to override confidentiality in certain cases, under the IESBA Code, of laws requiring confidentiality to be maintained in certain circumstances to avoid ‘tipping off’.
- How incidences of NOCLAR are communicated to the group auditor.
- The implications for the IAASB standards relating to review and other assurance engagements.

Mr. Van der Ende noted that it was helpful to have IESBA and the IAASB working together and that the IAASB may need to consider safe harbors and how differences in legal frameworks affect the auditor’s obligations.

WAY FORWARD

Subject to the Working Group’s deliberations, an IAASB ED will be presented at the June 2015 IAASB meeting for approval.

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1 The minutes of the March 2015 IAASB meeting will be approved at the June 2015 IAASB meeting.

2 Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants.
Objectives of the IAASB Discussion

The objectives of the IAASB discussion at its June 2015 meeting are to:

(a) Approve a project proposal on amendments to International Standards in response to the International Ethics Standards Board for Accountants’ (IESBA) project on NOCLAR.

(b) Approve the proposed amendments to the International Standards for exposure and agree an appropriate exposure period.

Background

1. At its April meeting, the IESBA approved a re-exposure draft of the NOCLAR proposals. The ED is open for comments until September 4th, 2015. The ED is included as Agenda Item 2-G for information.

2. As requested by the IAASB at its March 2015 meeting, the IAASB’s NOCLAR Working Group has focused on whether amendments to the IAASB’s International Standards should be limited to changes to avoid inconsistencies with the proposed revised IESBA Code, or whether the proposed revised IESBA Code indicates areas of the International Standards that may warrant further exploration by the IAASB in due course. It was noted that changes beyond the minimum to avoid inconsistencies between the International Standards and the revised IESBA Code may need to be considered as part of the IAASB’s next work plan. Following such consideration, as appropriate, the Working Group developed responses to clarify the implications for the IAASB’s International Standards of, and to emphasize in those standards, the changes made by IESBA regarding the professional accountants’ obligations regarding NOCLAR, including confidentiality. These responses have benefited from the involvement of a member of the IESBA NOCLAR Task Force on the IAASB’s Working Group, as well as IESBA staff.

Section I – Project Proposal

Section I-A – Project Proposal Considerations

3. The project proposal has been reviewed by both the Steering Committee and the IAASB NOCLAR Working Group (see Agenda Item 2-B). The project objectives are to:

(a) Identify any actual or perceived inconsistencies of approach or scope between the NOCLAR proposals and the International Standards, including ISA 250;  

(b) Develop amendments to the International Standards to address such inconsistencies to the extent considered appropriate to enable the International Standards to continue to be applied effectively with the IESBA Code or to clarify and emphasize key aspects of the proposed revised IESBA Code in the International Standards; and  

(c) Make other recommendations, as appropriate, including identifying other areas where further improvements may need to be considered in due course.

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3 The IAASB’s International Standards comprise the International Standards on Auditing (ISAs), International Standards on Review Engagements (ISREs), International Standards on Assurance Engagements (ISAEs), International Standards on Related Services (ISRSs), and International Standards on Quality Control (ISQCs).

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

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4. The scope of this project covers actual or perceived inconsistencies of approach and scope between the IESBA NOCLAR proposals and the International Standards. This project will not address other potential amendments to ISA 250 or other International Standards in an effort to achieve improvements in those Standards in the immediate term. However, the project Task Force may make other recommendations, as appropriate, regarding other aspects of ISA 250 where further improvements may need to be considered in due course (for example, under a future IAASB Work Program).

5. The Working Group believes an expedited approach to this project is necessary and appropriate given the limited nature and scope of the anticipated amendments to the International Standards and the importance of providing stakeholders with an opportunity to consider the proposed amendments to the International Standards and the IESBA’s NOCLAR proposals side by side. As the proposed “Process to Address Circumstances Requiring an Accelerated Response” has not yet been finalized, Staff has evaluated the project proposal and noted that it incorporates the elements and steps of the proposed accelerated response process, which is aligned to the elements of the IAASB’s normal due process. The Project Proposal includes a timetable detailing how the project is intended to proceed.

Section I-B – Implications of the Proposed Restructure of the IESBA Code

6. The IESBA is aiming to close off the proposed NOCLAR standards under its extant drafting conventions (termed a “close-off document”) by Q1 2016. It then intends to restructure the close-off document in accordance with the new structure and drafting conventions for the IESBA Code, which it is currently developing under a separate project. No change in meaning is intended as part of this restructuring exercise. The restructured NOCLAR standards are intended to be exposed for comment on the restructuring only. The IESBA is aiming to approve the restructured Code by Q4, 2016 with the effective date to be determined in due course.

7. For information, “close-off documents” were used in the IAASB’s Clarity project to seek the Board’s approval of the final policy decisions and text of each ISA while the restructuring of the ISAs into their current form was undertaken. A close-off document means that the Board approves the text of the amendments to the standard, but does not issue the standard until the restructuring/redrafting process is complete. The restructuring or redrafting process is not intended to result in changes of meaning. The Standard-Setting Board (SSB) is then asked to approve the restructured standard, but does not further deliberate the content of the standard or re-discuss the policy positions set by the SSB in its approval of the close-off document.

8. Due to the IESBA’s intention to approve a restructured Code by Q4 2016, it is intended (based on the current IESBA timetable) that the IAASB will approve the amendments to the International Standards in a close-off document as well, in approximately Q1 2016. After the restructuring of the IESBA Code is complete, the project Task Force would then review the implications of the final changes to the IESBA Code arising from the restructuring and make a recommendation to the IAASB regarding the approval of the amendments included in the close-off document, in approximately Q4, 2016.

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5 www.ethicsboard.org/projects/structure-code
Matter for IAASB Consideration

1. The IAASB is asked to approve the Project Proposal as shown in Agenda Item 2-B

Section II – Issues

Section II-A – Introduction to the Working Group’s Approach

Process

9. As noted in Section I, the proposed ED addresses only (i) actual or perceived inconsistencies of approach or scope to the extent considered appropriate to enable the International Standards to continue to be applied effectively, once the final IESBA NOCLAR standard becomes effective and (ii) amendments to clarify and emphasize key aspects of the proposed revised IESBA Code in the International Standards.

10. The Working Group reviewed the IESBA’s NOCLAR proposals, other than aspects that do not relate to the IAASB’s International Standards, such as the provisions for Professional Accountants in Business, and compared the proposals against relevant provisions of the International Standards.

11. In its discussions, the Working Group focused on identifying issues and categorizing them by the Working Group’s proposed response as follows:

   (a) Category 1 – Amendments to address actual or perceived inconsistencies of approach or scope or to clarify and emphasize key aspects of the NOCLAR proposals, such as the changes to the confidentiality responsibilities. These changes are included in the proposed ED (see Agenda Items 2-C and 2-D and Section II-B below).

   (b) Category 2 – Additional guidance material that might be considered helpful if added to ISA 250, or other International Standards, but is not considered to be of sufficient importance to warrant their inclusion in the ED as proposed amendments (see Agenda Item 2-E and paragraph 15 below).

   (c) Category 3 – Areas for further consideration in a possible future revision of ISA 250. The Working Group identified other issues related to how the International Standards address the auditor’s responses to NOCLAR (see Agenda Item 2-F and paragraph 16 below). These issues may result in changes to the scope and approach of extant ISA 250. The Working Group does not believe these issues should be addressed at this time. The Working Group does, however, believe that respondents’ consideration of the proposals in the ED, and future consideration of these issues by the IAASB, may be facilitated by highlighting these areas in the Explanatory Memorandum of the proposed ED as matters not addressed at this time, supported by an appropriate question for respondents.

Comparison Documents

12. To facilitate the IAASB’s review of the Working Group’s proposals, the Working Group has prepared comparison documents to highlight selected aspects of ISA 250 and IESBA’s NOCLAR proposals. These documents are:

   (a) Agenda Item 2-D, which lists Category 1 issues;
(b) **Agenda Item 2-E**, which lists Category 2 issues; and

(c) **Agenda Item 2-F**, which lists Category 3 issues.

**Section II-B – Proposed ED**

13. The Working Group’s proposed amendments in **Agenda Item 2-C** address the Category 1 issues described above and are drawn from, or based on, the IESBA's proposed amendments. Broadly, the proposed amendments can be characterized as follows:

(a) “Signpost” provisions that bring key aspects of the IESBA’s NOCLAR proposals to the auditor’s attention. For example ISA 250, paragraph 8a and ISA 240,6 paragraph 8a, highlight that the auditor may have additional obligations under relevant ethical requirements regarding NOCLAR which are proposed to change;

(b) Proposed amendments to recognize and reflect the changes to the auditor’s duty of confidentiality, particularly the right to disclose identified or suspected NOCLAR to an appropriate authority. See:

(i) ISA 250, paragraph A19;

(ii) ISQC 1,7 paragraph A56;

(iii) ISA 240, paragraphs 43 and A65

(iv) ISRE 2400 (Revised),8 paragraph A92; and

(v) ISAE 3402,9 paragraph A53;

(c) New guidance to clarify the implications of the IESBA’s NOCLAR proposals for ISA 250, such as the possibility that the auditor may otherwise become aware of matters that the auditor is required to address under relevant ethical requirements, and which may have an effect on the audit. Illustrations of this type of proposed amendment are in ISA 250, paragraphs A12a and A17a. For example, if the auditor becomes aware of NOCLAR that the auditor is required to address under relevant ethical requirements, such non-compliance is relevant to the auditor’s responsibilities under paragraphs 18-21 of ISA 250—for example, such non-compliance may cause the auditor to evaluate the integrity of management and, when appropriate, those charged with governance, even if the non-compliance does not have a material effect on the financial statements;

(d) New guidance to highlight the requirement in the IESBA NOCLAR ED for the auditor to communicate, prior to accepting the engagement, with the predecessor auditor—ISA 220,10 paragraph A8a;

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6 ISA 240, *The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements*

7 ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

8 ISRE 2400 (Revised), *Engagements to Review Historical Financial Statements*

9 ISAE 3402, *Assurance Reports on Controls at a Service Organization*

10 ISA 220, *Quality Control for an Audit of Financial Statements*
(e) New guidance to recognize that laws or regulations may prohibit alerting ("tipping off") the entity when, for example, the auditor is required to report the NOCLAR to an appropriate authority pursuant to money laundering legislation—ISA 240, paragraph A65; ISA 250, paragraph A19; ISA 260 (Revised),\(^\text{11}\) paragraph A8; ISA 450,\(^\text{12}\) paragraph A8:

(f) Additional examples or explanatory material that the Working Group believes would be sufficiently significant in clarifying the text of applying the International Standards to warrant proposed amendments. For example:

(i) ISA 250, paragraph A1a – highlights that management and those charged with governance may have additional responsibilities;

(ii) ISA 250, paragraph A7a – Includes examples of relevant laws and regulations drawn from the IESBA NOCLAR ED; and

(iii) ISA 250, paragraph A18a – Examples of circumstances that may cause the auditor to evaluate the reliability of written representations; and

(g) Minor changes for consistency with the IESBA NOCLAR ED in ISA 250, paragraph 5.

14. The Working Group believes that these amendments address actual or perceived inconsistencies of approach or scope or clarify and emphasize key aspects of the NOCLAR proposals.

Section II-C – Other Elements of the IESBA’s NOCLAR ED

15. To aid the IAASB in understanding which items were in “Category 2,” as described in Section II-A above, the Working Group has prepared a comparison document which includes the relevant provisions of the IESBA ED and the related paragraphs from the International Standards (see Agenda Item 2-E). These items are not included in the proposed ED.

16. The Working Group also identified the following items in “Category 3,” as described in Section II-A above. These items are listed below and are not included in the proposed ED, but are areas for possible future exploration (see also Agenda Item 2-F):

(a) The distinction between the types of laws and regulations\(^\text{13}\) and the different levels of work effort applied to each under extant ISA 250, and whether an alternative approach is warranted.

(b) Whether ISA 250 should deal with all personal misconduct of those charged with governance, management, and employees related to the business activities of the entity.

(c) Whether the list of agents (those charged with governance, management, and employees) in the definition of “non-compliance” in paragraph 11 of ISA 250 is sufficiently broad to include, for example, contractors and sub-contractors.

\(^\text{11}\) ISA 260 (Revised), Communication with Those Charged with Governance

\(^\text{12}\) ISA 450, Evaluation of Misstatements Identified During the Audit

\(^\text{13}\) ISA 250, paragraph 6, distinguishes the auditor’s responsibilities in relation to compliance with two different categories of laws and regulations as follows: (a) The provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements such as tax and pension laws and regulations; and (b) Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business, to an entity’s ability to continue its business, or to avoid material penalties.
(d) Whether ISA 250 should address making inquiries of management or, when appropriate, those charged with governance, regarding NOCLAR that “may occur” – which is included in IESBA's NOCLAR ED.

(e) Whether ISA 250 should include a requirement to obtain an understanding of how management identifies and addresses known or suspected NOCLAR as an essential component in obtaining an understanding of the entity and its environment.

(f) Whether ISA 620\textsuperscript{14} should require the auditor to include in the written agreement with an auditor’s expert that the expert must inform the auditor if the expert becomes aware of NOCLAR in the entity.

(g) How incidences of NOCLAR are communicated to the group engagement team. At the March 2015 IAASB meeting, the Working Group was asked to also consider this point. The Working Group discussed the issue and concluded that it is beyond the scope of the project proposal as it does not specifically relate to the IESBA's NOCLAR proposals.

17. In addition to these areas, respondents may have their own views on matters that may need to be considered in any future revision of ISA 250, and may have views on the urgency of the need to revise ISA 250.

18. The Working Group is therefore of the view that including a specific question on these matters in the Explanatory Memorandum would be helpful for the IAASB in developing its consultations on its future Work Plans and assessing the relative priority of any possible additional efforts relating to ISA 250 against other priorities.

**Matters for IAASB Consideration**

2. The IAASB is asked to provide its views on the proposed ED as shown in Agenda Item 2-C, and to approve its issuance.

3. Does the IAASB support inclusion of a question in the Explanatory Memorandum to the ED to seek views about areas within ISA 250 that may warrant further attention in a future IAASB work plan?

**Section III – Way Forward and Due Process**

**Section III-A – Opportunities for Further IESBA/IAASB Interaction**

19. The IAASB's NOCLAR project will feature close interaction between the IAASB and IESBA, particularly in relation to comments received on the IAASB ED and IESBA Re-ED. As this project is based on making amendments in light of the NOCLAR proposals, the final amendments to the International Standards will take into account the final NOCLAR standards approved by the IESBA. Accordingly, the IAASB and IESBA will interact at a staff, task force, and Board level as appropriate in relation to any comments on the respective EDs that may be relevant to either Board.

20. While preparing the draft ED for this meeting, the Working Group noted that there were areas within the IESBA NOCLAR ED that the Working Group would seek to discuss further with IESBA to improve both the IESBA and the IAASB’s understanding of the issues. Examples of areas for possible discussion include:

\textsuperscript{14} ISA 620, *Using the Work of an Auditor's Expert*
• Whether explicit or implicit references in the NOCLAR proposals to the IAASB International Standards are appropriate. For example, section 225.31 of the NOCLAR ED includes references to ISA 230’s documentation requirements.
• Whether there should be additional references to the impact of NOCLAR on the financial statements.
• Whether there are aspects of ISA 250 that would be useful additional material for inclusion in the IESBA NOCLAR material. One example is paragraph 23 of ISA 250 regarding communication of a matter to those charged with governance as soon as practicable when, in the auditor’s judgment, non-compliance is believed to be intentional and material.

Section III-B – Significant Matters Identified by the IAASB Working Group

21. In the Working Group’s view, the significant matters it has identified as a result of its deliberations since the beginning of this project, and its considerations thereof, have all been reflected in the issues papers presented to the IAASB at its meetings. In the IAASB Working Group’s view, there are no significant matters it has discussed in this project that have not been brought to the IAASB’s attention.

22. The Working Group does not believe that a consultation paper, field testing, or a roundtable is warranted, as the proposed amendments are only limited in nature. The Working Group believes that effective consultation with the public is best achieved by the issuance of an ED with an overlapping exposure period with the IESBA ED.

Section III-C – Exposure Period

23. As seen in Agenda Item 2-C, the proposed changes to the IAASB’s International Standards are limited in nature. In addition, the Working Group notes that there would be benefit in finalizing the proposed changes to the IAASB’s International Standards as timely as possible to align with the IESBA process as much as is feasible, given each Board’s meeting schedules. Accordingly, the Working Group believes there is merit in a shorter exposure period of 90 days.15

Matter for IAASB Consideration

4. Does the IAASB agree that an exposure period of 90 days would be appropriate?

15 Although the exposure period for a draft international standard will ordinarily be no shorter than 120 days, a shorter or longer exposure period may be set when considered appropriate. A shorter exposure period may be set, for example, where in the public interest there is a need to conclude on a matter more quickly, the exposure draft is relatively simple or short, or where the IAASB decides to re-expose all or only part of a draft international standard.