

**Basis for Conclusions**  
**Prepared by the Staff of the IESBA**  
*July 2016*

*International Ethics Standards Board  
for Accountants®*

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## **Responding to Non-Compliance with Laws and Regulations**

**IESBA**

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The objective of the IESBA is to serve the public interest by setting high-quality ethical standards for professional accountants and by facilitating the convergence of international and national ethical standards, including auditor independence requirements, through the development of a robust, internationally appropriate code of ethics.

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# **BASIS FOR CONCLUSIONS: RESPONDING TO NON-COMPLIANCE WITH LAWS AND REGULATIONS**

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## I. Introduction

1. This Basis for Conclusions has been prepared by staff of the IESBA. It relates to, but does not form part of, the IESBA Pronouncement, [Responding to Non-Compliance with Laws and Regulations \(NOCLAR\)](#). The pronouncement was approved by the IESBA in April 2016 with the affirmative votes of 18 out of 18 IESBA members present.

## II. Background

2. In providing a professional service to a client or carrying out professional activities for an employer, a professional accountant (PA) may come across an act or suspected act of NOCLAR committed (or about to be committed) by the client or employer, or by those charged with governance (TCWG), management or employees of the client or employer. The Board noted that the PA has a prima facie ethical responsibility not to turn a blind eye to the matter. At the same time, the Board recognized that such a situation can often be a difficult and stressful one for the PA. The Board therefore approved a project in 2010 to develop enhancements to the Code to help guide the PA in dealing with the situation and in deciding how best to act in the public interest in these circumstances.<sup>1</sup> Whether identified or suspected NOCLAR should be disclosed to an appropriate authority was one, although not the only, consideration in the project.
3. In August 2012, the Board issued a first exposure draft of its proposals, [Responding to a Suspected Illegal Act](#). Overall, respondents were supportive of the Board exploring appropriate responses by PAs to instances of NOCLAR or suspected NOCLAR in the public interest. Respondents from the regulatory community, in particular, were supportive of the Board's efforts to provide guidance not only to PAs in public practice performing audits of financial statements (auditors) but also to (a) PAs in public practice (PAPPs) providing services other than audits of financial statements (PAPPs other than auditors); and (b) professional accountants in business (PAIBs). There were, however, significant concerns across most stakeholder groups regarding the operability of the proposals, whether they were appropriately balanced, and the potential for unintended consequences.<sup>2</sup>
4. In the light of these substantive concerns, the Board held three global roundtables in Hong Kong SAR, Brussels, Belgium, and Washington DC, USA, in 2014 to solicit further views and input from stakeholders on the issues. Over 160 senior-level delegates from a wide range of stakeholder groups representing 27 jurisdictions, including 13 G-20 countries, participated in the roundtables, indicating the importance of, and high level of interest in, this topic. In addition, observers from the Public Interest Oversight Board (PIOB) and the International Auditing and Assurance Standards Board (IAASB), as well as the Chair of the IESBA Consultative Advisory Group (CAG), attended the events.
5. As a result of the feedback from respondents to the first exposure draft, the roundtable input<sup>3</sup> and the Board's further deliberations and consultations with the IESBA CAG and other stakeholders, the Board developed revised proposals in the form of a framework<sup>4</sup> for PAs to respond to instances of NOCLAR or suspected NOCLAR.

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<sup>1</sup> The project proposal can be accessed [here](#).

<sup>2</sup> A comprehensive summary of the significant comments on the August 2012 Exposure Draft can be accessed [here](#).

<sup>3</sup> A comprehensive summary of the roundtable input can be accessed [here](#).

<sup>4</sup> The final response framework, refined based on stakeholder feedback, is set out in the Appendix.

6. The Board published the revised proposals in a second exposure draft (the ED) in May 2015. The comment period for the ED closed on September 4, 2015. Seventy-seven comment letters were received from various respondents, including regulators and audit oversight bodies, national standard setters, IFAC member bodies, other professional organizations, and firms. This Basis for Conclusions explains the more significant issues raised by respondents to the ED, and how the Board has addressed them.
7. The Board discussed this project with its CAG on 12 separate occasions: at the project commencement stage; prior to the issuance of each exposure draft; and prior to the finalization of the pronouncement. The Board also held numerous discussions with the regulatory community, policy makers, investor representatives, national standard setters, the Forum of Firms, the IFAC Small and Medium Practices (SMP) Committee, the IFAC PAIB Committee, and IFAC member bodies, among others. In addition, the Board liaised closely with the IAASB in the finalization of the project.

### **III. Supporting Implementation of a Reporting Requirement in Law or Regulation**

8. The explanatory memorandum (EM) to the ED asked for respondents' views as to whether the proposals would support implementation or application of a legal or regulatory requirement to report NOCLAR or suspected NOCLAR to an appropriate authority.
9. A substantial body of respondents across all stakeholder categories agreed that the proposals would do so. Some respondents in particular noted that:
  - The proposals would help emphasize PAs' responsibility to comply with applicable laws and regulations, and provide useful context to understanding the nature of the legal or regulatory requirements.
  - The proposed framework should assist PAs in responding to NOCLAR in jurisdictions where the law or regulation merely contains a reporting requirement but does not include guidance to assist the PA in discharging that responsibility.
10. Several respondents, however, disagreed or had reservations as to whether this would be the case, noting in particular the following:
  - It would depend on the nature of the applicable laws and regulations, and legislation may regulate the matter in different ways.
  - The existence of domestic law and regulation would override, and negate the need for, additional guidance in the Code.
  - It is questionable whether the Code can be effective as guidance to supplement specific national laws.

#### **IESBA Decision**

11. The Board considered that overall, respondents appeared to support the view that the provisions would provide helpful guidance to PAs in implementing or applying a legal or regulatory reporting requirement. The Board noted that judgment necessarily will be called for in following the guidance in the provisions, taking into account the nature of the particular reporting requirement.

#### **IV. Usefulness of Provisions Where No Reporting Requirement in Law or Regulation**

12. The EM asked for respondents' views as to whether the proposals would help guide PAs in acting in the public interest where no legal or regulatory reporting requirement exists.
13. A substantial body of respondents across all stakeholder categories agreed that the proposals would do so.
14. A number of other respondents disagreed or only partially agreed for various reasons, including the following:
  - The IESBA is not the appropriate institution to establish provisions for regulating the disclosure of NOCLAR to an appropriate authority; this should be left to lawmakers who can provide legal certainty; and for auditors, the approach to reporting NOCLAR in ISA 250<sup>5</sup> should be sufficient.
  - The proposals could be further strengthened to require disclosure to an appropriate authority if this would be, on balance, in the public interest, after due consideration of any potential adverse consequences and if not prohibited by law or regulation.
  - The proposals regarding the matters the auditor would potentially disclose to an appropriate authority and the circumstances surrounding a determination to do so were overly vague, and this lack of precision would create considerable uncertainty. In particular, the lack of legal certainty was of specific concern to some of those respondents.
  - The proposals were very detailed and to some extent overly complex.

#### **IESBA Decisions**

15. On the balance of the responses to this question, the Board considered that respondents broadly felt that the proposals would be helpful to PAs in guiding them to respond to NOCLAR matters where law or regulation has not prescribed any reporting requirement.
16. The Board noted that polarized views continue to exist between some stakeholder groups regarding whether the Code should address the matter of disclosure of NOCLAR to an appropriate authority. Given the overall broad support for the response framework across the various stakeholder categories, the Board determined that it had struck an appropriate balance on this matter.
17. With respect to the concerns about the lack of precision in some of the guidance, the Board also noted that a balance is important between maintaining the principles-based nature of the Code and providing overly detailed guidance that would render the Code prescriptive and remove the critical element of professional judgment or de-emphasize its importance. See also Section X below.

#### **V. Consideration of the Practical Aspects of the Proposals**

18. The EM invited views from respondents on the practical aspects of the proposals, particularly their impact on the relationships between (a) auditors and audited entities; (b) other PAPPs and their clients; and (c) PAIBs and their employing organizations. Views from respondents were diverse.

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<sup>5</sup> International Standard on Auditing (ISA) 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*

19. In relation to auditors and audited entities:

- Several respondents expressed recurring concerns about the potential for the proposals to jeopardize the trust relationship between auditors and audited entities, and therefore adversely affect the flow of information from the latter to the former. There were also concerns about the potential for unintended consequences and increasing the expectations gap. A few were concerned about increasing the complexity and cost of the engagement, especially for smaller firms, and the need to acknowledge this.
- Several other respondents, however, felt that the proposals would broadly encourage, or not adversely impact, the free flow of information between the two parties. Some also felt that the proposals may have a positive or strengthening effect on auditors' relationship with management, particularly through the value-add that auditors may provide in bringing NOCLAR issues to management's attention. Some also believed that the proposals would have no significant or unreasonable impact on the relationship where management integrity is not an issue.

20. In relation to other PAPPs and their clients:

- Several respondents expressed concern about the potential adverse impact on the level of trust and sharing of information between other PAPPs and their clients. Some highlighted the need to be sensitive to expectations of these other PAs to act as trusted advisors. Others were concerned about the potential for PAs to be placed at a competitive disadvantage relative to non-PAs with respect to the same services.
- Other respondents were of the view that there would likely be no significant or further impact on the relationship, particularly where integrity is not an issue. It was noted also that the proposals would clarify the responsibilities of each party and enhance the relevance of PAs' services.

21. In relation to PAIBs and their organizations:

- A few of the respondents were concerned about the potential adverse impact on the level of trust and sharing of information between the two parties.
- Other respondents felt that the proposals were proportional and balanced, and would avoid placing PAIBs at a professional disadvantage vs. non-PAs. Some were of the view that it is unlikely that there will be any change in the relationships, noting that the concept of whistleblowing is not new. It was also felt that there should be no unreasonable impact on the relationships where integrity is not an issue, and that the proposals may in fact enhance the credibility of the profession.

### **IESBA Decisions**

22. In the light of these comments, the Board believes that it has achieved an appropriate balance between the responsibilities of PAs and those of their clients or employing organizations, and also in terms of the approach to the different categories of PA.

23. The Board was not persuaded that allowing an override of confidentiality *under the Code* would result in management or TCWG no longer being forthright with information needed for the PA to discharge his or her professional responsibilities. If the ability of PAs to override confidentiality did adversely impact trust and information flow, the Board believes that this would already have been the case

where laws and regulations themselves permit confidentiality to be set aside in specific circumstances (for example, where auditors and other accountants are required to report financial irregularities, money laundering and criminal acts to appropriate authorities in some jurisdictions).

24. Importantly, the Board believes that in the vast majority of cases, there will be no question about the integrity of management and TCWG. The concern about the potential adverse impact on trust and information flow only becomes relevant if they are attempting to conceal their direct or indirect involvement in potential NOCLAR. If that were the case, the Board believes that it is highly unlikely that management or TCWG would be forthcoming with information that might compromise them, irrespective of what the Code might say.

## VI. Proposed Objectives

25. The ED proposed the following objectives for all PAs in public practice (PAPPs):

- (a) To comply with the fundamental principles of integrity and professional behavior;
- (b) By alerting management or, where appropriate, those charged with governance of the client, to seek to:
  - (i) Enable them to rectify, remediate or mitigate the consequences of the identified or suspected non-compliance; or
  - (ii) Deter the commission of the non-compliance where it has not yet occurred; and
- (c) To take such further action as may be needed in the public interest.

The ED also proposed similar objectives for PAIBs.

26. A substantial body of respondents across all stakeholder categories expressed support for all or almost all of the objectives.
27. A respondent was of the view that there was an element of circularity in that the third objective referred to taking such further action as may be needed in the public interest; however, the ED also required the PA to determine if further action is needed to achieve the PA's objectives. In addition, the respondent felt that the reasonable and informed third party provision (paragraph 25 of Section 225<sup>6</sup> in the ED) provided a useful context in which to frame the judgment regarding the need for further action (paragraph 225.20 in the ED). Accordingly, the respondent suggested merging both paragraphs as follows: *"The PA shall exercise professional judgment in determining whether further action is needed, taking into account whether a reasonable and informed third party, weighing..., would be likely to conclude that the PA has acted appropriately in the public interest."*
28. Another respondent suggested that the reference to the objectives in the requirement to determine if further action is needed, and the link between the objectives and the other factors to consider when determining whether further action is needed, should be clarified for purposes of driving consistency in application.

## IESBA Decisions

29. The Board accepted that some could perceive an element of circularity in how the third objective interacted with the requirement regarding further action. On further reflection, the Board determined

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<sup>6</sup> Section 225, *Responding to Non-Compliance with Laws and Regulations*



that it was unnecessary to refer to all the objectives when determining if further action is needed. This is because at that point in the process, the PA should already have raised the matter with management and, where applicable, TCWG (the second objective). Also, the fact that the PA would have responded to the matter at that point would largely have already enabled the PA to fulfill the first objective. Accordingly, recognizing that what really is at stake at that point is whether further action is needed in the public interest, the Board determined to:

- (a) Reword the third objective as: “To take such further action as appropriate in the public interest;” (see paragraphs 225.4(c) and paragraph 4(c) of Section 360<sup>7</sup>)<sup>8</sup> and
- (b) More specifically link the requirement regarding further action to the public interest (see paragraphs 225.25, 225.49 and 360.21).

30. The Board did not accept the suggestion to merge paragraphs 225.20 and 25 in the ED as it felt that doing so would blur the stand-back role that the third party provision is intended to serve regarding the PA’s responsibility to objectively evaluate the possible courses of further action. The Board nevertheless agreed to relocate the third party provision closer to the determination of the need for further action to make clearer the context for that judgment (see paragraphs 225.28 and 360.24.)

**Other Matters Related to Objectives**

31. Respondents also raised a number of other matters or suggestions, including the following:

#	Matter Raised	IESBA Decisions
1.	A respondent was of the view that the third objective might be difficult to achieve for (a) PAPPs other than auditors, and (b) PAIBs other than senior PAIBs. It was argued that this might especially be the case if, despite their best efforts, they do not have the necessary information to determine further actions or are precluded by law or regulation from taking further action. The respondent suggested that the third objective be amended to read: “ <u>Where possible, to</u> take such further action as may be needed in the public interest.”	The Board did not accept this suggestion as the third objective referred to “ <i>such</i> further action as <i>may be</i> needed in the public interest,” which will necessarily depend on having access to the relevant information. Further, with respect to PAPPs other than auditors, paragraph 225.42 of the ED already noted that the nature and extent of further action will depend on the legal and regulatory framework. Nevertheless, the Board believes that the refinement to the wording of the third objective as indicated above will assist in mitigating this concern.
2.	Some respondents were of the view that the second objective may have an unintended consequence in that it could lead PAs to ignore anti-tipping-off legislation. It was suggested that the provisions drawing attention to such consideration (paragraphs 225.10 (for auditors),	The Code does not override laws and regulations. Accordingly, a precondition to complying with the Code is that PAs first observe and comply with all applicable laws and regulations. The Board, however, accepted the suggestion to give greater

<sup>7</sup> Section 360, *Responding to Non-Compliance with Laws and Regulations*

<sup>8</sup> Paragraph numbers refer to the final pronouncement unless otherwise noted.

#	Matter Raised	IESBA Decisions
	<p>225.33 (for other PAPPs) and 360.10 (for PAIBs) in the ED) be moved to the start of the relevant sections.</p> <p>Related, a regulatory respondent noted that some of its audit oversight members had identified a number of instances in their inspections where firms had applied the Code’s provisions directly, without adapting their internationally developed policies to include more stringent locally applicable legislation. The respondent encouraged the Board to recognize and place emphasis on applicable laws and regulations that may be more stringent than the Code.</p>	<p>prominence to PAs’ responsibility to comply with applicable laws and regulations, including any prohibition on alerting the client or other relevant party prior to making disclosure. Accordingly, paragraphs 225.10 and 33 in the ED have been combined and relocated to paragraph 225.3, and paragraph 360.10 in the ED to paragraph 360.3.</p> <p>The Board also accepted to make clear in paragraphs 225.3 and 360.3 that there may be laws and regulations governing how PAs should address NOCLAR or suspected NOCLAR <i>which may differ from or go beyond Sections 225 and 360</i>, including requiring that the PA report the matter to an appropriate authority.</p> <p>However, this does not mean that the PA can elect to follow either laws and regulations or the Code in such a situation. In accordance with the Preface to the Code, PAs need to be aware of requirements and guidance in laws and regulations that differ from those in the Code and comply with the more stringent ones, unless prohibited by law or regulation.</p>
3.	<p>A respondent suggested that the objectives should instead include the following:</p> <ul style="list-style-type: none"> <li>• All PAs should not be associated with a client or employing organization that knowingly does not comply with laws and regulations and lacks integrity, unless disassociation is prohibited by law or regulation.</li> <li>• All PAs should be satisfied that, where possible and appropriate, disclosure of actual or suspected NOCLAR is made to an appropriate authority able to take action.</li> </ul>	<p>The Board did not accept these suggested objectives as they are much narrower in focus. Further, the focus on disassociation and on the possibility of disclosure to an appropriate authority was already covered in the ED.</p>
4.	<p>A few respondents were of the view that the fundamental principles should be the overarching objectives or primary driver of PAs’ responses.</p>	<p>The Board noted that complying with the fundamental principles is the overarching objective in the Code. However, a primary aim of the project is to help <i>guide</i> PAs in responding to NOCLAR or suspected NOCLAR and in deciding how best to act in the</p>

#	Matter Raised	IESBA Decisions
		public interest in the circumstances. The Board noted that such guidance is currently lacking in the Code.
5.	A respondent was of the view that it is inappropriate for the response framework for senior PAIBs to be broadly comparable to that for auditors given the widely differing missions for each group and dissimilar organizations.	The Board accepted that senior PAIBs do operate in different roles and organizations and perform different professional activities compared with auditors. Nevertheless, public expectations of them in responding appropriately to NOCLAR issues will be equally high given their levels of influence and decision-making ability within their organizations. This was a key point of consensus during the IESBA’s global roundtables on this project.
6.	A respondent was of the view that the proposals introduce a different understanding of the public interest than what is already in the Code. It was argued that if compliance with the Code is acting in the public interest, it was unclear what further action may be needed or expected by PAs to act in the public interest.	The Board noted that the Code currently lacks guidance for PAs in how to respond to NOCLAR or suspected NOCLAR. Accordingly, complying with the Code as it stands will likely not assist PAs in fulfilling their responsibility to act in the public interest in such circumstances.

## VII. Concept of Public Interest

32. The ED referred to the public interest in a number of places, including in the objectives.
33. A number of respondents expressed concern that there were no clear definition and common understanding of the concept of “public interest.” Some were of the view that the “public interest” is very subjective, particularly given cultural differences, and that there would therefore be potential for inconsistent application and unintended consequences. Others felt that PAs will feel compelled to take legal advice as a defensive measure, or that they will be second-guessed by regulatory authorities. Some of them suggested the need for more guidance. In contrast, a respondent was of the view that a strict definition of “public interest” should be avoided and that it would be better to leave it principles-based.
34. A few respondents commented that the guidance in paragraphs 225.4 and 360.4 of the ED regarding what constitutes the public interest seemed too wide and indefinite, and therefore not useful. It was also pointed out that while the guidance referred to “immediate or ongoing consequences,” it had omitted to refer to probable consequences.

### IESBA Decisions

35. The Board noted that seeking to define the concept of “public interest” would be a significant endeavor that would go beyond the scope of this project. The ED already contained guidance in

paragraphs 225.27 and 360.26 (paragraphs 225.34 and 360.29 in the final pronouncement) to assist PAs in interpreting it in the specific context of NOCLAR. Professional judgment will be essential. However, in response to the calls for more guidance, the Board determined to add two further examples of circumstances where the PA may determine that disclosure to an appropriate authority would be an appropriate course of action in the public interest:

- Where the entity or employing organization is engaged in bribery, for example, bribery of local or foreign government officials for purposes of securing large contracts.
- Where the entity or employing organization is promoting a scheme to its clients to assist them in evading taxes.<sup>9</sup> (See paragraphs 225.34 and 360.29).

36. The Board did not accept the comments about second-guessing as such a concern could be raised equally in any other circumstance where PAs are called to exercise professional judgment. Rather, the Board expects that PAs will act reasonably and in good faith, and their actions judged on that basis.
37. With respect to the comments concerning the guidance in paragraphs 225.4 and 360.4 of the ED, the Board accepted on further reflection that this guidance was not adding substantively to the specific guidance that had already been provided in paragraphs 225.27 and 360.26 of the ED. Accordingly, the Board determined that paragraphs 225.4 and 360.4 of the ED be deleted.

## VIII. Scope of the Proposals

### Laws and Regulations Covered

38. The ED proposed that Section 225 address:
- (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.

The ED proposed a similar scope of laws and regulations for Section 360.

39. A substantial body of respondents across all stakeholder categories supported or largely supported the proposals.
40. Specific matters respondents raised included those set out below.

### NOCLAR Committed by Parties Who Work for the Organization Other Than Employees

41. A few respondents commented that the proposals did not appear to cover NOCLAR committed or that may be committed by parties who work for the organization apart from employees (for example, non-executive directors, contractors and agents).

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<sup>9</sup> Tax evasion is an act of NOCLAR. It is distinct from tax avoidance, which is not.

### *IESBA Decisions*

42. The Board accepted this observation, especially as in practice many parties may work for the entity but not necessarily through an employment contract. To make it clear that NOCLAR committed by these parties is in scope, the Board determined to amend the definition of NOCLAR in paragraphs 225.2 and 360.2 to include acts committed by individuals working for or under the direction of a client or the employing organization. Conforming changes were made to other provisions in Sections 225 and 360.

### **Distinguishing between Varying Degrees of Public Interest**

43. A few respondents were of the view that the proposals did not adequately recognize that there may be varying degrees of public interest. In particular, it was felt that differentiating only between “audits of financial statements” and “non-audit services” in Section 225 implied that all audits carry the same level of public interest. It was argued that the voluntary audit of a small unlisted entity has significantly fewer public interest implications than, for example, the statutory audit of a large listed financial institution. Accordingly, it was suggested that the Board acknowledge the special public interest connotations applicable to the audit of financial statements of public interest entities (PIEs) as opposed to other audits and other services performed by PAs.

### *IESBA Decisions*

44. The Board had considered but rejected making a distinction between PIEs and entities that are not PIEs. This is because a NOCLAR issue with the potential for substantial harm to stakeholders can arise in a PIE just as well as in an entity that is not a PIE. The Board therefore determined to emphasize in paragraph 225.1 that the section applies regardless of the nature of the client, including whether or not it is a PIE. A similar change has been made in paragraph 360.1.
45. The Board also did not believe that it would be appropriate to distinguish between whether an audit of financial statements is being undertaken for voluntary or statutory purposes. This is because Section 225 is focused on potential adverse consequences of NOCLAR to stakeholders, including the general public, and not the nature or size of the audience for the auditor’s report.

### **Assurance Engagements where Subject Matter is not Financial Statements**

46. A respondent was of the view that the proposed scope of laws and regulations was not appropriate for assurance engagements where the subject matter is not financial statements. The respondent believed that the proposals should complement not only the ISAs but also the IAASB’s International Standards on Assurance Engagements (ISAEs) which apply to other assurance services. It noted that ISAEs do not refer to laws and regulations that have a direct effect on the financial statements but to those that have a direct effect on the subject matter of the engagement. Accordingly, the respondent suggested that the wording of the proposed scope refer to “the determination of material amounts and disclosures in the underlying subject matter information.”

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47. The Board noted that paragraphs 21-22 of the EM had explained the rationale for the approach to the scope of laws and regulations covered. The Board also noted that a focus on laws and regulations that have a direct effect on the recognition or measurement of the subject matter in a non-audit assurance engagement could be unduly narrow as it could lead the PA not to respond to NOCLAR

or suspected NOCLAR that may have a significant adverse impact on the entity's financial statements or its operations, even if the PA had recognized such issue. Conversely, the Board believes there will be few instances of significant NOCLAR related to the subject matter of a non-audit assurance engagement that will not have a significant impact on the entity's financial statements or its operations eventually. The Board therefore resolved not to make a change in response to this suggestion.

48. The Board, however, acknowledged that the further removed an instance of NOCLAR or suspected NOCLAR within the scope of the laws and regulations covered is from the subject matter in which the PA specializes or with respect to which the PA performs professional activities or provides professional services, the less likely it is that the PA will recognize it. For example, an assurance practitioner who specializes in performing assurance engagements on greenhouse gas emissions will be less likely to recognize NOCLAR related to tax laws applicable to the entity than a PA who provides tax services to the entity, and vice versa. Accordingly, the Board does not expect that PAs will necessarily be able to recognize NOCLAR related to all laws and regulations within the scope of Sections 225 and 360. In this regard, paragraph 225.40 makes clear that the professional accountant is expected to apply knowledge, professional judgment and expertise, but is not expected to have a level of understanding of laws and regulations beyond that which is required for the professional service for which the accountant was engaged. In addition, the provisions apply to NOCLAR or suspected NOCLAR that comes to the PA's attention; they do not require the PA to perform procedures to identify NOCLAR or establish an expectation that the PA will do so.

### **Forensic-Type Engagements**

49. Several respondents were of the view that forensic services where a PAPP is engaged to investigate suspected wrongdoing should be exempt from the provisions regarding disclosure to parties outside the client, even when legal privilege does not apply. It was noted that many forensic engagements may not be under legal privilege, and the reference to legal privilege in paragraph 225.44 of the ED would limit the exclusion to circumstances where there is a legal basis for preclusion.

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50. The Board noted that paragraph 225.44 of the ED had referred to legal privilege as only an example of a circumstance where the terms or nature of the engagement might preclude external disclosure. Importantly, the Board did not believe that it would be appropriate for the Code to prohibit disclosure to an appropriate authority even in the case of forensic-type engagements, as such a preclusion would be contrary to the overriding objective for the PA to act in the public interest. Rather, whether the aim of the engagement is to investigate potential wrongdoing within the entity is a factor the PA should take into account in considering whether to disclose the matter outside the client.
51. The Board therefore determined to clarify this consideration as follows:
- Whether the purpose of the engagement is to investigate potential non-compliance within the entity to enable it to take appropriate action. (See paragraphs 225.47 and .52)

### **Clearly Inconsequential Matters**

52. A respondent expressed concern that the scope of the proposals appeared too broad in covering matters that are other than clearly inconsequential. The respondent felt that this would impose an unnecessary and inappropriate burden on PAs to pursue matters of little significance. It suggested that the proposals should focus only on matters of significant public interest.

### *IESBA Decision*

53. The Board noted that it had discussed at length the approach regarding scoping out clearly inconsequential matters. The Board's rationale in this regard had been set out in paragraphs 30-34 of the EM. As respondents overwhelmingly supported this approach, the Board determined that no change should be made.

### **Interaction of Scope of Laws and Regulations and Threshold of Clearly Inconsequential Matters**

54. A respondent commented that the proposed scope of laws and regulations covered in Section 225 (paragraph 225.5 of the ED) appeared to indicate that NOCLAR matters that are "material" or "fundamental" in nature are the starting point. Accordingly, it wondered about the purpose of paragraph 225.8 in the ED which scoped out matters that are "clearly inconsequential." The respondent therefore suggested re-consideration of the interactions of the scoping distinctions.

### *IESBA Decisions*

55. The Board noted that the definition of the scope of laws and regulations in Section 225 is not focused on NOCLAR matters that are "material" or "fundamental" in nature. At the point of becoming aware of information suggesting a possible NOCLAR, without first having obtained an understanding of the matter the PA will not know whether it is material or fundamental to the entity's financial statements or operations. Rather, the scope definition specifies the *types* of NOCLAR with which the PA should be concerned under the Code, i.e., it defines the population of NOCLAR matters that are in scope rather than the threshold below which those matters are out of scope.
56. The starting point of Section 225 is therefore not acts of NOCLAR that are of a material or fundamental nature. Indeed, part of the response framework is focused on directing the PA to obtain an understanding of the matter, including its nature and potential consequences. Some matters that the PA may encounter or be made aware of might be clearly inconsequential. Section 225 therefore scopes out such matters.
57. To make this clearer, the Board resolved to make the following changes:
- (a) Rewording the lead-in to paragraph 225.5 to state that the section "sets out the approach to be taken by a PA who encounters or is made aware of non-compliance or suspected non-compliance with" laws and regulations in the categories described in subparagraphs 225.5(a) and (b);
  - (b) Moving to a separate paragraph 225.8 the statement that a PA who encounters or is made aware of matters that are clearly inconsequential is not required to comply with the section; and
  - (c) Deleting the original scope-out provision regarding clearly inconsequential matters from paragraph 225.8 of the ED.
58. Corresponding changes were made to Section 360.

### **Other Laws and Regulations that Should be Covered**

59. Some respondents provided various suggestions for other laws and regulations they believed should be added to the illustrative list of laws and regulations covered, including those addressing data protection, privacy, occupational safety, employment, and fiduciary responsibilities.

*IESBA Decisions*

60. The Board noted that providing an overly detailed list would run the risk of making the guidance prescriptive. Importantly, there would be a danger that PAs would regard a very long list as comprehensive and not exercise appropriate professional judgment. The Board nevertheless agreed to add the example of data protection to the list in recognition of the significant financial and other consequences to entities and the general public that breaches of data protection laws can have (see paragraphs 225.6 and 360.6).

**Other Matters Related to Scope**

61. Respondents also raised a number of other matters or suggestions, including the following:

#	Matter Raised	IESBA Decisions
1.	A respondent expressed the view that the proposed scope was too limited and narrower than that of ISA 250. The respondent believed that ISA 250 does not restrict the scope of laws and regulations covered in an audit of financial statements. It argued that all PAs should be required to respond appropriately when they identify matters that they know or suspect to be NOCLAR, and not just laws and regulations related to the preparation of financial statements or that are fundamental to the entity's business. The respondent did not believe that it was acceptable that PAs' responsibilities with respect to other laws and regulations should be subject to same ethical expectations as ordinary good citizens, as the Board had stated in the EM.	The Board noted that placing no limitation on the scope of laws and regulations covered would lead to an undue burden being placed on PAs, over and above what it would be reasonable to expect them to respond to by virtue of their professional training and expertise. The Board reaffirmed its view that it should be a personal responsibility for PAs to determine whether and how they should respond to NOCLAR outside the scope of laws and regulations covered by the sections.
2.	A respondent was of the view that the limitations on the scope of laws and regulations covered would result in the auditor not considering all required irregularities to respond to in accordance with applicable legal or regulatory requirements relevant for the audit. The respondent suggested that the Board consider increasing the scope of elements to be considered. The respondent also suggested that the Board make clear that the level of scope set by the Code would not capture the higher level of requirements that could apply in a number of jurisdictions around the world.	The Board noted that the proposals already required PAs to understand and comply with applicable laws and regulations governing responding to NOCLAR. Accordingly, the proposals already were aimed at enhancing PAs' compliance with applicable legal and regulatory requirements. Nothing in the Code is intended to detract from such requirements.  The Board also noted that the explicit recognition in paragraph 225.3 that there may be legal or regulatory provisions that may differ from or go beyond Section 225 would largely alleviate such concern.



## IX. Differential Approach for Different Categories of Professional Accountant

62. The ED proposed a differential approach among the four categories of PA regarding responding to identified or suspected NOCLAR.
63. A substantial body of respondents across all stakeholder categories agreed or largely agreed with the proposal.
64. Some respondents disagreed or only partially agreed for various reasons, including the following:

#	Matter Raised	IESBA Decisions
1.	<p>The differentiation should be based primarily on the expected level of understanding of laws and regulations that may be relevant to the scope of PAs' responsibilities and their ability to investigate further and take action.</p>	<p>The Board noted that differentiating on the basis of the "expected" level of understanding of laws and regulations would create significant uncertainty as to which PAs should be subject to the more stringent framework. This approach would presuppose that every PA's level of understanding of laws and regulations relevant to their responsibilities would be capable of being objectively assessed in order for the framework to be enforceable. In practice, it is likely that there will be significant variation in such understanding, even for a specific type of PA within a particular category (for example, given the complexity of tax laws in many jurisdictions, it is unlikely that a uniform level of understanding of such laws could be clearly defined among all tax partners in a particular jurisdiction, especially given variations in levels of experience and degrees of specialization, and responsibilities that are often not finely delineated). The Board therefore believes that this approach would be difficult to operationalize.</p> <p>With respect to differentiating on the basis of PAs' ability to investigate further and take action, the Board noted that the proposed response framework already takes these into account.</p>
2.	<p>Both PAPPs other than auditors and PAIBs other than senior PAIBs should be exempt from the response framework.</p> <p>For the former, the engagements are limited in scope and it is often impractical for them to access</p>	<p>The Board noted that these categories of PA have an overarching responsibility to respond to NOCLAR or suspected NOCLAR pursuant to the first objective. However, the response framework for them is much less demanding than that for auditors and senior PAIBs, in</p>

#	Matter Raised	IESBA Decisions
	<p>relevant information outside these engagements. Accordingly, it would be difficult for them to obtain a further understanding of, and make a judgment about, the matter.</p> <p>For the latter, it would be extremely difficult for them to obtain information outside the scope of their designated roles and the related authority assigned to them. Accordingly, they would not be able to apply the provisions in practice.</p>	<p>recognition precisely of the limitations highlighted by the respondent. In particular, paragraphs 225.39 and 360.33 only require them to <i>seek</i> to obtain an understanding of the matter, recognizing that constraints on their access to information may preclude them from obtaining such an understanding.</p> <p>In addition, for PAPPs other than auditors, paragraph 225.49 only requires them to <i>consider</i> (and not determine) whether further action is needed in the public interest; and for PAIBs other than senior PAIBs, they are only required to raise the matter through their organizations' established protocols and procedures, or bring it to the attention of their superior (paragraph 360.35). Therefore, as the response framework for these categories of PAs is already undemanding, the Board did not believe that it would be appropriate to exempt them completely from the framework.</p>
3.	<p>It would be inappropriate for senior PAIBs to have to comply with broadly the same response framework as auditors, given their different roles and operating contexts. In addition, PAIBs' responses would be better linked to their operating contexts as opposed to their seniority.</p>	<p>The Board acknowledged that PAIBs and auditors operate in different roles and in different environments. However, public expectations of senior PAIBs in responding to NOCLAR are as equally high as for auditors, given the former's decision-making ability and their greater spheres of influence within their organizations (as the feedback from the NOCLAR roundtables indicated). As respondents have overwhelmingly supported the proposed response framework for senior PAIBs, the Board determined that no change should be made.</p> <p>With respect to the suggestion to differentiate the response framework on the basis of senior PAIBs' operating contexts, the Board believes that this would create significant uncertainty from a definitional perspective given that the operating contexts in which these individuals work vary enormously in practice.</p>

#	Matter Raised	IESBA Decisions
4.	The differential approach may encourage a more rules-based approach to ethical decision-making and a move away from the conceptual framework.	The Board noted that the aim of the project is to <i>help</i> guide PAs in responding to what will often be challenging NOCLAR situations. While the conceptual framework provides a tool to ensure compliance with the fundamental principles, it alone would be insufficient to assist PAs in responding appropriately in the circumstances.

### Other Specific Matters

65. A respondent expressed the view that if auditors become aware of existing or potential NOCLAR when performing services other than audits of financial statements (non-audit services) for an entity, they should be required to take the same steps as if the matter were identified in the course of the audit. A few other respondents suggested that the proposed framework for auditors should also apply to PAs performing other assurance engagements. They believed that the same duty of care that applies to auditors in relation to NOCLAR exists for those other PAs.
66. A respondent questioned why the responsibilities of PAPPs other than auditors should not include the same proposed responsibilities for auditors as set out in paragraphs 225.17-19 of the ED (addressing the matter with management and those charged with governance), and why there were differences in the factors to consider when determining whether further action is needed. A few other respondents suggested that consideration be given to extending the guidance applicable to auditors in paragraphs 225.27-28 of the ED (concerning disclosure to an appropriate authority) to other PAPPs.

### *IESBA Decisions*

67. The Board noted that the nature of non-audit services (including other assurance engagements) that PAPPs may perform for audit clients is extremely diverse. These PAs may often not have the same level of access to information, management and TCWG as auditors. The non-audit services themselves may be one-off limited scope engagements and their duration relatively short. Accordingly, the Board believes that it would be unreasonable to require PAPPs performing these non-audit services to apply the same response framework as auditors. Nevertheless, as noted in paragraph 83 of the EM, jurisdictions are not precluded from extending the framework for PAPPs performing audits of financial statements to PAPPs performing other engagements if they believe that doing so would serve their national needs.
68. With respect to the suggestion to extend the guidance for PAPPs other than auditors, the Board had given careful consideration to whether to reproduce for these PAPPs the guidance applicable to auditors. Paragraph 76 of the EM had set out the Board's rationale in this regard, i.e., to avoid conveying the impression that the former has the same level of responsibility to respond to NOCLAR or suspected NOCLAR as the latter. The former, however, would not be precluded from considering the guidance applicable to the latter. The Board therefore determined to not change this balance in the guidance.

## X. Factors to Consider Regarding Further Action

69. In relation to auditors and senior PAIBs, the ED proposed factors to consider in determining the need for, and the nature and extent of, further action.
70. A substantial body of respondents across all stakeholder categories agreed or largely agreed with the proposed factors.
71. A number of respondents nevertheless had reservations about aspects of the proposals, or disagreed, for various reasons, including the following:
  - The factors (and in particular the terms “credible evidence,” “substantial harm” and “serious adverse consequences”) are subjective, too vague and will require complex determination; more guidance was needed, including on the interaction of the factors.
  - It would be better to retain “public interest” as a factor vs. “substantial harm,” as the latter is not as widely understood as the former. In addition, the former would encourage a more proactive consideration of the circumstances vs. a minimum level for action.
  - PAs are likely to take a narrow reading of these provisions and take further action only if *all* the factors are present.
  - The proposals do not adequately address instances where there may be a difference in professional judgement about whether the matter is in fact an instance of NOCLAR, such as in relation to the application of tax laws.

### IESBA Decisions

72. The Board noted that a delicate balance needs to be achieved in terms of providing sufficient guidance to PAs in the Code while at the same time allowing sufficient room for them to exercise appropriate professional judgment in applying the provisions. Professional judgment is in fact essential to the PA discharging the PA's responsibilities. The Board believes there would be a significant risk of departing from principles and taking a prescriptive route if overly detailed guidance were to be provided. In the light of the substantial support for the proposals, the Board believes that an appropriate balance has been struck. Accordingly, the Board determined not to expand further the guidance provided.
73. The Board, however, determined to commission IESBA Staff to develop appropriate tools and resources to support implementation of the provisions. The Board believes that there are opportunities for others to contribute to the efforts to assist implementation through the development of resources such as case studies.

## XI. Third Party Test

74. The ED proposed a third party test regarding the determination of the need for, and nature and extent of, further action for both auditors and senior PAIBs.
75. A substantial body of respondents across all stakeholder categories agreed or largely agreed with the proposal.
76. A number of respondents nevertheless had reservations about aspects of the proposal, or disagreed, for various reasons, including the following:

- The test creates a de facto requirement in certain severe cases. It also exposes the auditor to potential litigation from both sides, so the auditor is de facto not free to decide whether or not to disclose the matter to an appropriate authority.
- The test is too subjective and its application would vary depending on the facts, circumstances and cultural context, particularly given the link to the concept of public interest.
- In practice, the test will be difficult to apply as it is likely that it can only be applied in hindsight, whereas PAs must make the judgment as events unfold. It would be better that PAs be required to simply use their professional judgment.
- It is unlikely that a third party would have the experience necessary and the context to judge the actions of PAs; a better test could be another PA placed in the same situation.

### **IESBA Decisions**

77. The Board had considered all of these arguments at length in deliberating the appropriateness and placement of the test. In particular, as explained in paragraph 54 of the EM, the test is intended to bring a degree of objective rigor to the PA's assessment, and not to force the PA to disclose regardless of the particular facts and circumstances at the time. The Board noted that the test involves consideration of those facts and circumstances *at the time* and in good faith. Accordingly, the Board did not accept the concerns about hindsight judgment.
78. The Board also did not share the perception that the test is imposing a de facto requirement because whether or not disclosure to an appropriate authority should be made will depend on the PA's objective assessment of the specific facts and circumstances at the time, taking into account the PA's objectives under Sections 225 and 360 as applicable.
79. The Board, however, accepted a comment from a respondent who noted that the test should also apply to the determination of the need for further action, and not only to the determination of the nature and extent of further action. Accordingly, the Board has made this clarification in paragraphs 225.28 and 360.24.

## **XII. Possible Courses of Further Action**

80. The ED proposed examples of possible courses of further action for auditors and senior PAIBs.
81. A substantial body of respondents across all stakeholder categories agreed or largely agreed with the proposal.
82. Some respondents nevertheless had reservations about aspects of the proposal, or disagreed, for a number of reasons, including the following:
- If management or TCWG have not taken appropriate action, the auditor should be obliged to report the matter to an appropriate authority if the auditor has confirmed that it is in the public interest to do so, provided that this would not be prohibited by law or regulation and there is legal protection for the auditor.
  - Mandating disclosure of the matter to an appropriate authority would be the only way to guarantee that full use is made of PAs' vital role in detecting corruption.
  - Addressing disclosure of NOCLAR to an appropriate authority should be a regulatory matter, not a standard-setting one.

## **IESBA Decisions**

83. The Board had deliberated at length the issue of disclosure of NOCLAR or suspected NOCLAR to an appropriate authority, and explained its approach and rationale in the EM. It noted that while views on this issue continue to be divided, there were no new arguments from respondents that it had not previously considered. The Board reaffirmed its belief that the approach to disclosure to an appropriate authority in the framework is robust and conceptually sound vis-à-vis the imperative for the Code to be capable of global application.
84. Therefore, given the substantial body of support across all stakeholder categories for the approach regarding possible courses of further action, the Board determined not to change this element of the response framework.

## **XIII. Factors to Consider Regarding Disclosure to an Appropriate Authority**

85. With respect to auditors and senior PAIBs, the ED proposed a list of factors to consider in determining whether to disclose the matter to an appropriate authority.
86. A substantial body of respondents across all stakeholder categories agreed or largely agreed with the proposal.
87. Some respondents nevertheless had reservations about aspects of the proposal, or disagreed, for a number of reasons, including the following:
- The consideration regarding whether there exists robust and credible protection from civil, criminal or professional liability may encourage a PA not to make the disclosure where it would be appropriate to do so. In particular, many jurisdictions may not have explicit “robust” legal or regulatory protection, but it may be generally established that a PA would not be held in breach of a duty of confidentiality if the PA could demonstrate that he or she acted reasonably and in good faith.
  - Considerations should include aspects such as legal risks associated with the auditor potentially making a false accusation, and breaking client confidentiality without the client’s knowledge or consent.
  - The factors are vague and subjective.
  - The list of factors is based on ideal-type contexts, which will not be found in reality; the most effective way to deal with NOCLAR would be for lawmakers to compel and enable PAs to disclose to a specific authority.
88. Some respondents also felt that there was a need to give greater prominence to the statement in paragraph 225.27 of the ED that disclosure would be precluded if contrary to law or regulation.

## **IESBA Decisions**

89. The Board did not believe that these arguments would help achieve a better or improved balance in the list of factors the PA should consider in determining whether to make disclosure. Indeed, the Board believes that this balance is crucial to achieving a neutral stance, enabling the PA to exercise appropriate professional judgment in an objective manner, taking into account the specific facts and circumstances at the time. Accordingly, the Board determined not to make substantive changes to the guidance.

90. The Board, however, accepted the suggestion to give greater prominence to the statement that disclosure would be precluded if contrary to law or regulation. The Board has therefore relocated it to the beginning of the provision (see paragraphs 225.33 and 360.28).

#### **XIV. Disclosing the Matter to the External Auditor**

##### **Communication to a Network Firm**

91. The ED proposed that:
- (a) If a PA is performing a non-audit service for an audit client of the firm, the PA communicate the NOCLAR or suspected NOCLAR within the firm; and
  - (b) If a PA is performing a non-audit service for an audit client of a network firm, the PA consider whether to communicate the matter to the network firm.
92. A substantial body of respondents across all stakeholder categories expressed support for the proposal.
93. Several respondents suggested that the Board explicitly recognize that such disclosure would be conditional on law or regulation not prohibiting it, or be subject to the purpose of the engagement. There was a concern in particular that the disclosure may be problematic where the Code is adopted into law and the disclosure would be prohibited under confidentiality laws. A few respondents suggested that guidance (including off-Code guidance) be provided to assist networks and their member firms in implementing the provision. Another respondent observed that the generalization in the EM that there should not be impediments to reporting the matter within the firm may be too broad.
94. Some respondents disagreed with the proposal, arguing that there was no justification for the differential treatment. It was noted in particular that firms and network firms are treated in a similar manner in Section 290,<sup>10</sup> and that the public would reasonably expect information to be shared within the network.
95. A few respondents were of the view that there should be a requirement to communicate the matter to the network firm unless prohibited by law. It was argued that if the matter is not communicated to the network firm, the auditor would be conducting the audit with incomplete information.
96. A respondent argued that the communication within the firm required in paragraph 225.39 of the ED should not be necessary where management takes appropriate and timely actions and/or management communicates with the engagement partner for the audit.

##### *IESBA Decisions*

97. The Board believes that from a public perception standpoint, there will be a strong expectation that information about NOCLAR or suspected NOCLAR be shared within the firm, provided that this would not be prohibited by law or regulation. However, for the reasons set out in paragraph 77 of the EM, the Board believes that the position with respect to communication to a network firm may be more complex and nuanced. The Board therefore believes that the latter situation should be subject to more judgment, particularly given that the network firm may be a different legal entity based in another jurisdiction. Accordingly, the Board reaffirmed the differential approach taken in the ED regarding communication within the firm and to a network firm (see paragraphs 225.44-45). The Board believes

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<sup>10</sup> Extant Section 290, *Independence – Audit and Review Engagements*

that this position is appropriately balanced, taking into account the practical considerations regarding communication across a network.

98. With respect to the factors to consider, the Board noted that paragraph 225.44 of the ED had already set out a number of them to take into account when considering whether to disclose the matter outside the client, in the context of considering the nature and extent of further action. The Board intended disclosure outside the client to include circumstances where the client is an audit client of the firm or a network firm. One of these factors specifically addressed the concern about whether the disclosure would be contrary to law or regulation. To ensure that these factors are not overlooked, the Board determined that they be reproduced immediately after the requirements in paragraphs 225.45-46 to consider whether to disclose the matter to the external auditor (see paragraph 225.47). The Board also determined to add to the list of factors consideration of the likely materiality of the matter to the audit of the client's financial statements, as was mentioned in paragraph 77 of the EM.
99. The Board considered the suggestion that communication within the firm should not be necessary where management has taken appropriate and timely actions and/or management has communicated with the engagement partner for the audit. The Board noted that precluding disclosure to the external auditor if management has taken appropriate and timely actions could leave out matters that may be relevant to the audit (for example, in terms of understanding the actual consequences on the financial statements, or considering whether the matter could cast doubt on management's integrity). The Board, however, accepted that the communication may not be necessary where the external auditor is a network firm or another firm if management or TCWG have already communicated the matter to the external auditor. Accordingly, the Board has added this as a further factor to consider (see paragraph 225.47).
100. The Board believes that these changes respond to the calls for more guidance on applying this aspect of the proposals. Additionally, because many firms and networks may already have internal protocols and procedures regarding how such matters should be communicated, the Board determined that the communication within the firm or to a network firm should first be made in accordance with such protocols and procedures or, if these do not exist, directly to the audit engagement partner. (See paragraphs 225.44-45.)

#### **“Passing the Buck”<sup>11</sup>**

101. A few respondents expressed concern about PAPPs other than auditors and senior PAIBs disclosing NOCLAR or suspected NOCLAR to the firm that is the external auditor. They felt that this could amount to “passing the buck” to the auditor and therefore place undue responsibility on the auditor, who may not be able to take appropriate action within a reasonable timeframe. It was suggested that for these PAPPs, communication to the firm that is the external auditor be a required additional consideration vs. a potential course of further action, consistent with the consideration of disclosure to a network firm.
102. A few respondents also questioned why the existence of a network should trigger a consideration for the PA to inform the external auditor of matters below the “further action required threshold,” whereas when the client is not an audit client of the firm or a network firm, there was no such consideration of informing the external auditor.

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<sup>11</sup> Or shifting or attributing one's own responsibility to another person or group



### *IESBA Decisions*

103. The Board noted that even if PAPPs other than auditors and senior PAIBs have disclosed the matter to the firm that is the external auditor, they would continue to have responsibilities under the framework (including considering or determining the need for further action). Accordingly, these PAs should not consider their responsibilities under the Code discharged simply by passing along the information to the external auditor.
104. However, for PAPPs providing a non-audit service to a client that is not (a) an audit client of the firm or a network firm, or (b) a component of an audit client of the firm or a network firm, the Board accepted on reflection that it would be appropriate to better distinguish disclosure to the firm that is the external auditor from the more drastic further action of disclosure to an appropriate authority. The latter would be at the end stage of the process, at which point it would be only about matters in respect of which there is credible evidence of substantial harm. Accordingly, the Board determined that for these PAPPs, they be required to *consider* whether to communicate the matter to the firm that is the external auditor, if any (subject to the same factors as the consideration of disclosure to a network firm), as opposed to considering such communication as a potential course of further action as paragraph 225.43 of the ED had proposed (see paragraphs 225.46-47).

### **Prescribing, Managing and Controlling Information Flow within the Firm**

105. A respondent expressed the view that the requirement in paragraph 225.39 of the ED for the PAPP performing a non-audit service for an audit client of the firm to communicate the matter within the firm would not be workable in practice unless the firm has a system in place to appropriately manage, control and protect the information. The respondent also felt that it was unclear from the ED how the communication would occur.

### *IESBA Decision*

106. The Board noted that prescribing, managing and controlling the flow of information within the firm are practice, risk management and quality control matters outside the scope of this project. Accordingly, the Board determined that these are matters that this project cannot address.

## **XV. Communication with Respect to Groups**

107. A few respondents suggested that it would be helpful to enhance the focus on the difficulties arising for auditors when faced with NOCLAR in a group audit situation, whether or not the auditors involved belong to the same network. There was a view that such an increased focus may contribute to a consistent approach by the auditors of subsidiaries within a group and could facilitate the communication between those auditors and the auditor of the consolidated financial statements. It was also suggested that the Code should clearly articulate that the lead audit engagement team should be notified in all cases when an act of NOCLAR arises in any jurisdiction during the performance of an audit or a non-audit service at a component. Another respondent suggested adding a requirement to consider informing the group auditor of the matter if the entity subject to audit procedures is a component of a group.
108. Related, in response to the changes proposed by the IESBA, the IAASB sought clarification as to whether the proposals in Section 225 regarding communication with respect to audits of group financial statements would apply to:

- (a) All components in a group whose financial information is subject to work for purposes of the audit of the group financial statements (for example, a review of a component's financial information); and
- (b) NOCLAR or suspected NOCLAR identified in the course of an audit that is *not* undertaken for group audit purposes (for example, a statutory audit of a component's financial information).

## **IESBA Decisions**

109. The Board accepted that there was a need to enhance the provisions in Section 225 regarding communication within a group as the guidance provided in the ED lacked sufficient specificity. The Board did not believe that it would be appropriate to rely on ISA 600<sup>12</sup> to provide the necessary direction and guidance in this regard as Section 225 serves different objectives compared with the ISAs. In this regard, the Board noted that the IAASB is currently exploring a project where it will be considering possible revisions to ISA 600 to address, in the context of an audit of group financial statements, the communication between the group engagement team and those performing work on financial information related to components for purposes of the audit of group financial statements. In addition, the Code and the ISAs are independent of each other and jurisdictions do not necessarily adopt them together. However, in developing the enhanced provisions addressing communication with respect to groups in Section 225, the IESBA's NOCLAR Task Force liaised closely with the IAASB's NOCLAR Task Force in conjunction with the Chair of the IAASB's Group Audits Working Group.

### *Audits of Financial Statements*

110. The Board determined that the communication requirements with respect to groups should encompass:
- (a) PAs performing work on financial information related to a component for purposes of an audit of group financial statements (see paragraph 225.21(a)); and
  - (b) PAs engaged to perform an audit of a component's financial statements for purposes other than the group audit, for example, a statutory audit (see paragraph 225.21(b)).
- Such communication requirements would be two way between auditors of such components and the group engagement partner (see paragraph 225.22).
111. The Board determined that the Code should address communication with respect to groups as follows:
- (a) Where the NOCLAR matter has been identified at a component, either in respect of which the PA has been requested by the group engagement team to perform work on the component's financial information for purposes of the group audit, or where the PA has been engaged to perform an audit of the component's financial statements for purposes other than the group audit, the PA would be required to communicate upstream to the group engagement partner (see paragraph 225.21); and
  - (b) Where the PA acting in a group engagement partner capacity becomes aware of the NOCLAR matter in the course of an audit of the group financial statements, including as a result of being

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<sup>12</sup> ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

informed of such a matter in accordance with paragraph 225.21, the PA would be required to communicate downstream to those performing work at components where the group engagement partner considers that the matter may be relevant to that component (see paragraph 225.22).

112. The Board believes that the upstream communication, irrespective of the size of the component, is important because the NOCLAR or suspected NOCLAR may have significant implications for the group as a whole. These implications include, for example where the matter is pervasive to the group, the potential for the integrity of management or TCWG to be called into question, or a potential adverse impact on the financial statements of the group. Paragraph 225.21 therefore articulates the purpose of the upstream communication, making it clear that this is to enable the group engagement partner to be informed about the matter and to determine, *in the context of the group audit*, whether and, if so, how it should be addressed in accordance with Section 225. For the avoidance of doubt, the Board does not intend the group engagement partner to be responsible for determining the response of the PA performing work at the component in accordance with Section 225. However, in determining whether and, if so, how to address the matter at a group level, the group engagement partner may consider how the matter has been dealt with at a component level, for example the response of component management. The placement of this paragraph is not intended to suggest that the group engagement partner must first be informed of the matter prior to the PA performing work at the component making a determination that disclosing the matter to an appropriate authority would be an appropriate course of action, and making such disclosure. However, in some circumstances, it may be helpful for the PA to consult with the group engagement partner in responding to the matter.
113. The Board also believes that the downstream communication is important because other components may be implicated, for example, in money laundering and other NOCLAR that could involve other parties within the group as counter-parties. Paragraph 225.22 therefore articulates the purpose of the downstream communication, making it clear that this is to enable those responsible for work at such components to be informed about the matter and to determine whether and, if so, how it should be addressed in accordance with Section 225.
114. However, the Board does not believe that it would be appropriate to direct the downstream communication automatically at those doing work at components, recognizing that this may create an undue and disproportionate burden. This may be particularly so in the case of groups with very large numbers of components, and where work at some or many of the components may be performed for purposes other than the audit of the group financial statements (for example, statutory audits of small components). Accordingly, the Board resolved that the downstream communication be subject to the group engagement partner's judgment as to whether the matter may be relevant to specific components. In addition, the Board recognized that there may be practical difficulties in identifying who might be undertaking audits of components' financial statements for purposes other than the group audit. The Board therefore resolved that in these circumstances, the group engagement team make appropriate inquiries (either of management or from publicly available information) *if necessary* as to whether the relevant component(s) is subject to audit and, if so, to ascertain to the extent practicable the identity of the auditor. (See paragraph 225.22.) While these inquiries may highlight which components are subject to audit, the group engagement partner may have limited knowledge of the potential impact of the NOCLAR or suspected NOCLAR on such components. In such circumstances, the group engagement partner would be expected to apply professional judgment based on the nature and circumstances of the matter, but would not be

expected to perform extensive procedures and inquiries to determine the possible impact of the matter on these components.

115. With respect to upstream communication to the group engagement partner, the Board believes that the PA performing work on the component's financial information should obtain information about the group engagement partner by making appropriate inquiries of the component's finance function or of the controlling shareholder, or looking up publicly available information (if any).
116. The Board believes that it is important to emphasize that communicating upstream to the group engagement partner should not absolve the PA performing work at a component in the circumstances described in paragraph 225.21 from fulfilling the PA's responsibility to respond to the NOCLAR or suspected NOCLAR in accordance with the provisions of Section 225. The Board has therefore made this clear in that paragraph. Likewise, communicating the matter downstream to those performing work at relevant components in the circumstances described in paragraph 225.22 should not absolve the group engagement partner from responding to the matter *in the context of the group audit* in accordance with the provisions of Section 225 (see paragraph 225.22).
117. Both communicating upstream and communicating downstream would be subject to there being no law or regulation prohibiting such communications (see paragraphs 225.21-22).
118. The Board considered but did not believe that it would be appropriate to make communication with respect to the group conditional on assessing the appropriateness of the response of management and, where appropriate, TCWG. The Board noted that even if the matter were appropriately dealt with at the component level, it might be relevant at the group level or in other components—and vice versa—and the auditors of those entities may need to take action. Equally, communication of the matter by client management within the group does not guarantee that the matter will be brought to the attention of the group engagement partner or those performing work at components, as applicable.
119. As a result of the above enhancements, the bullet point in paragraph 225.19(b) of the ED referring to communication with the group engagement team in a group audit in the context of complying with applicable requirements under professional standards has been deleted.

#### *Non-Audit Services*

120. The Board also determined that where the PA is engaged to provide a non-audit service<sup>13</sup> to a component of an audit client of the firm or a network firm, and the PA becomes aware of NOCLAR or suspected NOCLAR, the Code should address communication within the firm or to the network firm. The Board determined that such communication, provided it is not contrary to law or regulation, should follow the same approach as communication where the non-audit service is provided to an audit client of the firm or a network firm, i.e.:
  - (a) A requirement to communicate the matter within the firm where the firm is the external auditor of the client of which the entity is a component (see paragraph 225.44); and
  - (b) A requirement to consider communicating the matter where a network firm is the external auditor of the client of which the entity is a component (see paragraph 225.45).

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<sup>13</sup> For the purposes of Section 225, a non-audit service may be an assurance service that is not an audit of financial statements (for example, a review or an audit of specific elements, accounts or items of a financial statement), or a non-assurance service.

121. Related to the communication where the non-audit service is provided to a component of an audit client of a network firm, the Board determined to include in the list of factors to take into account in considering the communication the likely materiality of the matter to the audit of the group financial statements. This is similar to the consideration of the likely materiality of the matter to the audit of the client's financial statements where the non-audit service is provided to an audit client of a network firm (see paragraph 225.47).
122. If communication of the matter to the network firm is made pursuant to the consideration required by paragraph 225.45, the network firm has a responsibility to comply with paragraph 225.21 in the context of the audit of the group financial statements, i.e., communicate the matter upstream to the group engagement partner, unless the network firm itself already is the group auditor.

## XVI. Disclosing NOCLAR to an Appropriate Authority without Following Specified Response Process

123. A respondent wondered whether PAs would be free to take relief from the duty of confidentiality under the Code and legitimately report NOCLAR or suspected NOCLAR to an appropriate authority without completing the response process set out in the Code. There was a concern that if management and TCWG are unwilling to speak with the PA about an instance of NOCLAR, not having completed this step in the process would lead the PA or others to conclude that the PA cannot disclose the matter to an appropriate authority.

### IESBA Decisions

124. As a matter of principle, non-response by management or TCWG to the PA would be grounds for the PA to determine that their response to the NOCLAR is not appropriate (paragraphs 225.23-24). Consequently, this may provide a basis for the PA to take further action in the public interest (paragraphs 225.25-26), which may include making disclosure of the matter to an appropriate authority (paragraphs 225.29, 225.33-35).
125. However, the Board determined that it would be appropriate to add a new provision to the sections for auditors (paragraph 225.36), other PAPPs (paragraph 225.54), and senior PAIBs (PAIBs) (paragraph 360.31) to enable these PAs to bypass the response process in order to make disclosure to an appropriate authority without the duty of confidentiality under the Code being considered to have been breached. This permission would only apply in *exceptional circumstances* where the PA has reason to believe there will be an imminent breach of a law or regulation that would cause substantial harm to stakeholders. In those circumstances, the Board accepted that PAs should not to be constrained by the specified process where adhering to that process would in fact lead to an outcome that would not be in the public interest.
126. While the Board believes that it is appropriate to provide this permission, it does not believe that bypassing the "due process" established within the response framework should be a routine occurrence. The guidance makes it clear that the PA must have *reason to believe* that the matter would constitute an imminent breach of a law or regulation that would cause substantial harm to stakeholders. The Board determined that this threshold is necessary so that there is not an unfettered right under the Code for the PA to disclose NOCLAR or suspected NOCLAR to an appropriate authority without a proper understanding of the issue. The Board also determined that prior to deciding on disclosure to an appropriate authority in these circumstances, the PA must consider whether it would be appropriate to discuss the matter with management or TCWG.

127. The Board did not believe that PAIBs other than senior PAIBs should be expected to take such action, although they would not be precluded from doing so under paragraph 360.36. This is not only because these other PAIBs have more limited access to information, but also because their response in such circumstances should reasonably be to immediately escalate the matter to their superior, consistent with the response framework.

## **XVII. Documentation**

128. The ED proposed that auditors be required to document a number of matters concerning significant identified or suspected NOCLAR. For the other categories of PA, it proposed that these PAs be encouraged to document a number of matters concerning such NOCLAR.

129. A substantial body of respondents across all stakeholder categories expressed support for the proposal. Individual respondents had varying suggestions on aspects of the proposal, including: considering a higher expectation about documentation for senior PAIBs; extending the documentation requirements to all PAPPs performing assurance engagements; and excluding PAPPs other than auditors and PAIBs other than senior PAIBs from the documentation proposal. None of these views, however, was shared to any significant extent by other respondents.

130. A number of respondents disagreed or only partially agreed with the proposal:

- A few felt that there was no reason why the same approach to documentation should not be applied to all categories of PA. They felt that a more robust approach to documentation was needed across the board, believing in particular that documentation could have a potential deterrent effect on management or TCWG were they inclined to breach laws and regulations.
- Some were of the view that the documentation requirement for auditors should not exceed the requirements in ISAs. It was also suggested that it would be better to locate all documentation requirements in ISA 250.
- A few were of the view that PAPPs other than auditors and senior PAIBs should also be subject to a documentation requirement, believing that a significant NOCLAR matter could be subject to legal proceedings and therefore a well-documented account of the matter could help establish the key decisions and positions taken by the PA.

131. A respondent questioned why the documentation requirement for auditors should be limited to “significant” NOCLAR. The respondent argued that there should not be a significance filter, particularly as no guidance was provided as to how significance would be assessed.

132. Another respondent suggested that the scope of the documentation provision for PAIBs other than senior PAIBs may need to be narrower given that they may not have access to management and TCWG.

## **IESBA Decisions**

133. The Board noted that some of the suggestions from respondents would detract from the need for a proportionate approach to documentation, or fail to recognize that PAs other than auditors are not subject to the same extent of regulatory oversight as auditors. This would also be more consistent with (a) one of the key aims of the project, which is to provide guidance to PAs in responding to NOCLAR, and (b) the Code’s current approach of generally advocating documentation in the PA’s interests but not requiring it.

134. The Board also did not accept the suggestions:
- That the documentation requirement for auditors should not go beyond what ISAs require. The Board noted that Section 225 serves different and wider objectives than the ISAs.
  - That it would be better to locate all the documentation requirements in ISA 250. The Board noted that the documentation requirement for auditors is a key element that contributes to the robustness of the response framework for them. Further, the Code needs to be able to operate independently of the ISAs. Not all jurisdictions that adopt the ISAs will adopt the Code, and vice versa.
135. Given the overall substantial support from respondents for the proposed approach to documentation, the Board reaffirmed that approach. However, in the light of the rewording of the requirements concerning further action (see Section VI above and paragraphs 225.25, 225.49 and 360.21), the Board made a conforming change to the last bullet of the relevant documentation provisions for PAPPs and senior PAIBs so that it addresses how they have fulfilled the respective responsibilities concerning further action (as opposed to how they have met the objectives). In doing so, the Board deemed it necessary to separate out documentation provisions for senior PAIBs and other PAIBs given that the framework does not impose a consideration of further action on the latter (see paragraphs 225.37 and 56, and 360.32 and 37).
136. With respect to the suggestion that the documentation requirement for auditors not be subject to a significance filter, the Board on further reflection noted that the documentation requirement in ISA 250 is not subject to such a filter. As a result, the Board believes that there would be potential for inconsistent documentation with respect to *identified or suspected* NOCLAR under the Code and under the ISAs, despite the fact that the Code would call for certain additional matters to be documented with respect to specific instances of NOCLAR or suspected NOCLAR. Accordingly, to make the threshold for documentation under the Code consistent with that under the ISAs, the Board determined to remove the significance filter from the documentation requirement (see paragraph 225.37). Conforming changes have been made to the corresponding provisions for documentation (which continue to be encouraged but *not required*) for PAPPs other than auditors, and for PAIBs (see paragraphs 225.56, 360.32 and 360.37).
137. Finally, the Board accepted the suggestion that the scope of the documentation provision for PAIBs other than senior PAIBs should be narrower. The Board therefore amended this provision to encourage them to document how their superior (as opposed to management and, where applicable TCWG) has responded to the matter (see paragraph 360.37).

## XVIII. Interaction with ISAs

138. In response to the IESBA's NOCLAR project, the IAASB also has undertaken a project in respect of NOCLAR in order to address actual or perceived inconsistencies of the approach to identifying and dealing with instances of identified or suspected NOCLAR in complying with the IAASB's International Standards when the Code also applies. While many respondents welcomed the Board's efforts to align the proposals more closely with the ISAs, including ISA 250, they raised a number of matters, including the following:

#	Matter Raised	IESBA Decisions
1.	<p>Several respondents were of the view that the Code should not extend auditors' obligations beyond those set out in ISA 250. There was a concern in particular that the Code would unnecessarily extend the auditor's work effort and documentation requirements, resulting in additional costs and delay to the audit. Some urged caution in not going too far beyond ISA 250.</p>	<p>The Board noted that Section 225 is intended to address auditors' ethical obligations with respect to NOCLAR. The objectives of Section 225 are different from those of ISA 250.<sup>14</sup> Accordingly, it is necessary to go beyond ISA 250 in certain respects, particularly in considering the wider public interest implications of NOCLAR. The Board therefore determined that there should not be a change in approach in this regard. Nevertheless, as explained in paragraph 29 of the EM, the provisions are intended to complement ISAs.</p>
2.	<p>Some respondents commented that the risk-based approach in the ISAs was not sufficiently clear in the proposals. They were concerned in particular that the proposals did not focus on material matters in terms of work effort.</p> <p>Some respondents also suggested that the Code should reflect the inherent limitations articulated in paragraph 5 of ISA 250<sup>15</sup> to mitigate the potential for unrealistic expectations.</p>	<p>The Board noted that Section 225 serves not only different but also wider objectives compared with the ISAs. Unlike the ISAs, Section 225 (a) does not require auditors to perform procedures to identify instances of NOCLAR, and (b) is not focused solely on potential material misstatement of the financial statements. Rather, the basic premise for the provisions is to enable the PA</p>

<sup>14</sup> Paragraph 10 of ISA 250 states that the objectives of the auditor are to:

- (a) To obtain sufficient appropriate audit evidence regarding compliance with 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;
- (b) To perform specified audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements; and
- (c) To respond appropriately to non-compliance or suspected non-compliance with laws and regulations identified during the audit.

<sup>15</sup> Paragraph 5 of ISA 250 states the following: "The auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements in the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the ISAs. In the context of laws and regulations, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for such reasons as the following:

- There are many laws and regulations, relating principally to the operating aspects of an entity, that typically do not affect the financial statements and are not captured by the entity's information systems relevant to financial reporting.
- Non-compliance may involve conduct designed to conceal it, such as collusion, forgery, deliberate failure to record transactions, management override of controls or intentional misrepresentations being made to the auditor.
- Whether an act constitutes non-compliance is ultimately a matter for legal determination by a court of law.



#	Matter Raised	IESBA Decisions
		<p>to appropriately <i>respond</i> to information indicating or suggesting an act of NOCLAR.</p> <p>The Board therefore determined that recognizing the inherent limitations set out in ISA 250, or reflecting the risk-based approach in the ISAs, would be inconsistent with that premise.</p>
3.	A few respondents suggested that the Board communicate with the IAASB that the PA's responsibility concerning NOCLAR be addressed in the PA's engagement letter with the client.	The Board noted that amendments to paragraph A24 of ISA 210 <sup>16</sup> were proposed by the IAASB's NOCLAR Task Force. These amendments address the auditor's responsibility to respond to NOCLAR, as indicated in <a href="#">Agenda Item 3-B</a> presented at the June 2016 IAASB meeting.
4.	A respondent noted that ISA 240 <sup>17</sup> is also relevant and any changes to the Code should also be reflected in ISA 240.	In response to the comment, the Board determined that Section 225 should specifically require auditors to comply with requirements in auditing standards relating to identifying and responding to NOCLAR, including fraud (see paragraph 225.20(b)). Further, the Board noted that the IAASB had proposed amendments to ISA 240 as part of its July 2015 Exposure Draft <a href="#">Responding to Non-Compliance or Suspected Non-Compliance with Laws and Regulations</a> , and as indicated in <a href="#">Agenda Item 3-B</a> presented at the June 2016 IAASB meeting.
5.	A few respondents expressed concern that the proposed requirement in paragraph 225.11 for the PA to obtain an understanding of the matter, <i>including the application of the relevant laws and regulations to the circumstances</i> , would lead auditors to obtain a more comprehensive understanding than required under ISA 250. The respondents noted that ISA 250 does not require such an understanding at this initial stage of the	The Board's intent was for the understanding of the matter that is to be obtained under Section 225 to be consistent with that under ISA 250. The Board acknowledged the risk that some could interpret the proposed requirement as far as establishing a legal position on the matter at such an early stage of the process. Accordingly, the Board determined to delete the bullet point referring

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Ordinarily, the further removed non-compliance is from the events and transactions reflected in the financial statements, the less likely the auditor is to become aware of it or to recognize the non-compliance.”

<sup>16</sup> ISA 210, *Agreeing the Terms of Audit Engagements*

<sup>17</sup> ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

#	Matter Raised	IESBA Decisions
	<p>process. They felt that such a requirement would be inappropriate, in particular because it could compel auditors to have to obtain legal advice before even having an initial discussion with management.</p>	<p>to understanding the application of the relevant laws and regulations to the circumstances (see paragraph 225.12).</p> <p>Corresponding changes have been made to paragraphs 225.39 (for other PAPPs) and 360.33 (for PAIBs other than senior PAIBs). The Board believes that it is within the roles and remits of senior PAIBs to obtain such an understanding.</p>
6.	<p>A respondent expressed concern that the phrase “consideration of the implications of the matter for the auditor’s report, <i>including disclosure in the report</i>” in paragraph 225.19 of the ED could have unintended consequences. The respondent felt that the phrase could suggest that an identified or suspected NOCLAR would ordinarily be considered a key audit matter under ISA 701.<sup>18</sup> The respondent noted that the proposals dealt with the difficult judgments involved in determining whether to disclose the matter privately to an appropriate authority, and that it would be inconsistent to suggest that the matter might readily be included in the auditor’s public report.</p>	<p>The Board acknowledged the respondent’s concern and determined that the reference to disclosure in the auditor’s report be deleted. This would still leave it to the auditor’s judgment to determine whether a particular instance of NOCLAR or suspected NOCLAR should be disclosed in the auditor’s report. The Board noted that amendments to ISA 250 were proposed by the IAASB’s NOCLAR Task Force addressing the communication of NOCLAR in the auditor’s report, when applicable, as indicated in <a href="#">Agenda Item 3-B</a> presented at the June 2016 IAASB meeting.</p>
7.	<p>A respondent noted that an auditor is required by paragraph 14 of ISA 200<sup>19</sup> to comply with the relevant ethical requirements, which ISA 200 explains as “ordinarily comprising Parts A and B of the IESBA Code of Ethics for Professional Accountants..., together with national requirements that are more restrictive.” The respondent believed that as the Code becomes increasingly stringent and potentially exceeds national law in isolated respects, the issue of how national ethical regimes might be measured against the Code in terms of their respective restrictiveness would need to be addressed. The respondent suggested that the IESBA and IAASB would need to consider the consequences for auditors and compliance with the</p>	<p>The Board acknowledged this concern and noted that this issue is one of the topics on which it has committed to engaging with the IAASB going forward.</p>

<sup>18</sup> ISA 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*

<sup>19</sup> ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

#	Matter Raised	IESBA Decisions
	ISAs in the event that national requirements are deemed less restrictive than the Code. The respondent accepted that this issue may need to be addressed “as a whole” rather in respect of isolated projects.	

## **XIX. Communication between Existing and Proposed Auditors**

139. Paragraph 13 of Section 210<sup>20</sup> in the ED proposed that where there is a change in auditors, the proposed auditor be required to request the existing auditor to provide known information regarding any facts or circumstances that, in the latter’s opinion, the proposed auditor needs to be aware of before deciding whether to accept the audit engagement. The ED also proposed to require the existing auditor to provide the information honestly and unambiguously provided there is client consent.
140. A few respondents expressed concern that instead of requiring the existing auditor to communicate information concerning the NOCLAR to the proposed auditor, paragraphs 210.11 and 210.13 in the ED would allow confidentiality to be used as a reason to restrict the communication of such a matter between the existing and proposed auditors. The respondents argued that confidentiality should not be a mechanism to restrict the existing auditor’s public-interest obligation to inform a proposed auditor of known facts and circumstances concerning NOCLAR or suspected NOCLAR.
141. Another respondent commented that even in jurisdictions where law or regulation already requires the proposed auditor to reach out to the existing auditor, there is a question as to whether the existing auditor will provide this information because of the potential for legal action by the client. In this regard, a respondent commented that the ED was silent regarding circumstances where the existing auditor does not, or refuses to, provide information regarding any facts or circumstances concerning the NOCLAR matter, even after having obtained the client’s consent. It was therefore suggested that the Code should provide guidance regarding such situations.

### *IESBA Decisions*

142. The Board acknowledged the public interest dimension of these concerns. The Board first determined to align terminology with the ISAs by referring in Sections 225 and 210 to “predecessor accountant” and “proposed successor accountant” where the PA has withdrawn from the professional relationship.
143. The Board noted that removing client consent from Section 210 as a precondition to the communication between the predecessor and proposed successor auditors could lead to the communication of matters unrelated to NOCLAR. In particular, unlike in NOCLAR situations, the Code would provide no criteria to guide the determination of when it would be appropriate to override confidentiality in those other situations—overriding confidentiality is a matter that should not be taken lightly. The Board therefore determined to retain the general requirement to obtain client consent. However, it resolved to allow an exception to client consent regarding communication of relevant information to the proposed successor accountant where the predecessor accountant has withdrawn

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<sup>20</sup> Section 210, *Professional Appointment*

from the professional relationship specifically by taking this course of action under Section 225 (see paragraphs 225.31 and 210.14).

144. To avoid placing an unreasonable burden on the predecessor accountant identifying who the proposed successor accountant might be, the Board also resolved that the communication be conditional upon the former being approached by the latter, as required by paragraph 210.14. In addition, to address the concerns regarding circumstances where the proposed successor accountant might be unable to communicate with the predecessor accountant for any reason, the Board has added guidance in paragraph 225.31 based on existing guidance in paragraph 210.13.

## XX. Other Matters

### Cross-Border Engagements and Interaction of the Code with Law

145. Several respondents suggested that more guidance be provided regarding how to deal with cross-border engagements (including international non-audit engagements). They felt, for example, that potential difficulties could arise where there are strict confidentiality laws in a component's jurisdiction but no conflict with laws and regulations in overriding confidentiality in a parent entity's jurisdiction. Some were of the view that the situation could be more problematic where legislation in some jurisdictions (such as the U.S. Foreign Corrupt Practices Act and the UK Bribery Act) has extra-territorial reach.
146. A few respondents also flagged the potential for conflicts between the Code and law where the Code is adopted directly into law. In this regard, it was suggested that the Board reach out to key jurisdictions to understand the implications of the statement in paragraph 225.29 of the ED to the effect that disclosure would not be considered a breach of the duty of confidentiality under Section 140.<sup>21</sup>

#### *IESBA Decisions*

147. The Board believes that it would not be practicable for the Code to attempt to deal with every possible set of circumstances that may arise in cross-border engagements in practice or where the Code is adopted into law. National standards setters, IFAC member bodies and firms would have to exercise appropriate judgment in implementing or applying the general principles in proposed Section 225 and deal with potential conflicts on a case-by-case basis, recognizing the general principle that the Code is subordinate to laws and regulations.

### Interaction with Contract Law

148. Some respondents perceived a lack of clarity regarding whether the Code can require PAs to override contractual obligations in relation to confidentiality. It was noted in particular that PAIBs may face an ethical dilemma where confidentiality is embedded into employment contracts.

#### *IESBA Decision*

149. The Board noted that it is a prerequisite to PAs discharging their professional obligations—whether as part of providing professional services to their clients or as part of undertaking professional activities for their organizations—that they comply with the relevant ethical requirements of their

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<sup>21</sup> Section 140, *Confidentiality*

professional bodies or that may apply to the particular engagements. Indeed, for PAPPs providing assurance services, ISA 210 notes that assurance engagements, including audit engagements, may only be accepted when the PAPP considers that relevant ethical requirements such as independence and professional competence will be satisfied.<sup>22</sup> The Board therefore determined that this is an engagement acceptance issue and not an ethical issue. The Board believes that firms can set clear client expectations at the outset by highlighting in their engagement letters specific ethical obligations with which they have to comply (including with respect to NOCLAR) in relation to the engagement. In this regard, the Board noted that amendments to paragraph A24 of ISA 210 were proposed by the IAASB's NOCLAR Task Force. These amendments address the auditor's responsibility relating to NOCLAR, as indicated in [Agenda Item 3-B](#) presented at the June 2016 IAASB meeting.

### **Recognizing that Auditors May be Made Aware of NOCLAR Outside of Performing the Audit**

150. A few respondents suggested that the framework for auditors should specifically address the actions the auditor should take in circumstances where another PAPP or a senior PAIB informs the auditor about a NOCLAR matter.

#### *IESBA Decision*

151. The Board accepted this suggestion as PAPPs should respond to a NOCLAR matter regardless of whether they encounter it during the performance of their engagements or are made aware of it by other parties. The Board therefore determined to make this clear in Section 225 (see paragraphs 225.1, 225.12 and 225.39).

### **Prompting Management and TCWG to Take Appropriate Action**

152. Paragraph 225.17 of the ED proposed that the PA be required to prompt management and, where appropriate, TCWG to take appropriate and timely actions if they agree that non-compliance has occurred or may occur and they have not already taken such actions.
153. A few respondents were of the view that the auditor should invite management and TCWG to take action in all such situations and not only when they agree on the facts. Another respondent commented that this condition could lead to misunderstanding that further actions from the auditor would only be required if management or TCWG agree that non-compliance has taken or may take place.
154. A few respondents also expressed concern about the use of the term "prompt," noting the risk of such action leading the auditor to take on management responsibility and therefore jeopardizing the auditor's independence.

#### *IESBA Decisions*

155. The Board acknowledged the concerns about making the auditor's actions conditional on management and TCWG agreeing to the facts. At that point in the process, the auditor will already have gathered an understanding of the matter, including through discussion with management and TCWG. Accordingly, the Board resolved to delete the condition (see paragraph 225.18).

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<sup>22</sup> ISA 210, paragraph A1

156. The Board also accepted the comments regarding the appropriateness of using the term “prompt.” The Board determined to use the term “advise” instead (see paragraph 225.18).

### **Monitoring and Assessing the Response of the Entity**

157. A few respondents were of the view that the auditor should monitor and assess the response of the entity before determining whether further steps are necessary. They noted that this assessment was expressed in a manner that would not create a clear requirement for the auditor in this area.

#### *IESBA Decisions*

158. The Board noted that requiring the auditor to monitor the response of management or TCWG could lead the auditor to take on management responsibility. The Board, however, accepted that it would be appropriate to make the need to assess their response explicit, as whether or not to take further action will be conditional on that assessment. Accordingly, the Board determined to (a) add a new requirement in paragraph 225.23 for the PA to assess the appropriateness of the response of management and, where applicable, TCWG, and (b) make clear in Section 225 that the determination of further action should be made in light of that response, i.e., based on the assessment of whether or not the response is appropriate, including whether it is timely (see paragraphs 225.24-25).
159. As a result of this change, the consideration of the factor regarding the appropriateness and timeliness of the response of management and, where applicable, TCWG in paragraph 225.21 of the ED has been deleted.
160. Corresponding changes have been made in Section 360 with respect to senior PAIBs (paragraphs 360.19-20 and 22).

### **Significant Shareholders**

161. A respondent asked that the Board clarify its intentions with respect to the PA’s potential interaction with sizable shareholders who have the ability to compel management to take appropriate action with respect to NOCLAR or suspected NOCLAR. The respondent believed that if the Board did not consider TCWG to likely include representatives of such shareholders, it would be appropriate for Sections 225 and 360 to advise the PA to discuss the matter with such shareholders, having regard to compliance with laws or regulations governing the ability to use this information.

#### *IESBA Decision*

162. Apart from the practical difficulty in defining what is a “sizable” ownership in a Code for global application, the Board does not believe that this suggestion would be workable in practice given the general legal doctrine regarding treating all shareholders equally with respect to disclosure of confidential information. In addition, the Board noted that TCWG will often already include representatives of “sizable” shareholders. The Board therefore resolved not to make a change in this regard.

## Section 360 Matters

163. Respondents raised a number of matters with respect to Section 360, including the following:

#	Matter Raised	IESBA Decisions
1.	Several respondents were of the view that the terms “senior PAIBs” and “other PAIBs” are not universally understood. There was a concern about potential difficulties in distinguishing between a senior PAIB and another PAIB, leading for example to a regulator taking a form-over-substance approach to enforcement with the benefit of hindsight. It was suggested that PAIBs’ responses would be better linked to their operating contexts (i.e., their roles and activities vs. their level of seniority).	The Board noted that the concept of a senior PAIB is principles-based. PAIBs will therefore need to exercise appropriate judgment in applying it. Further, as explained in paragraph 68 of the EM, the description of a senior PAIB is based on guidance on management responsibility that the Board had recently revised after full consultation with stakeholders and due process. Further, as discussed in Section IX above, the Board does not believe that it would be practicable to link PAIBs’ responses to their operating contexts given that these vary enormously. The Board therefore determined not to change the approach, which has been broadly supported by most other respondents.
2.	A few respondents commented that PAIBs may have difficulties in deterring NOCLAR. They suggested that PAIBs’ responsibility should be limited to explaining the NOCLAR and its consequences to management or TCWG.	The Board noted that senior PAIBs are only required to <i>seek</i> to deter the commission of a NOCLAR act (paragraph 360.17(e)). There is therefore already an implicit acknowledgement that these PAIBs may not always be able to deter a breach of laws and regulations. Section 360 places an indirect responsibility on other PAIBs to seek such deterrence through raising the matter up the chain of command within the organization.
3.	Paragraph 360.18 of the ED proposed to require the senior PAIB to disclose the matter to the external auditor, if any. A respondent expressed the view that where the consequences of the matter have been rectified, remediated or mitigated, disclosure to the external auditor should not be necessary.	The Board accepted that disclosure to the external auditor should not be necessary in all circumstances, especially if the matter is not material to the financial statements and the consequences of the non-compliance have been appropriately addressed. Accordingly, the Board resolved that the senior PAIB should only be required to determine whether disclosure to the external auditor is needed (see paragraph 360.18).
4.	A respondent suggested that resigning from an employing organization should be an option for	The Board noted that resignation from the employing organization is always an option –

#	Matter Raised	IESBA Decisions
	<p>other PAIBs just as much as it is for senior PAIBs, but this option was only presented for senior PAIBs. The respondent suggested adding this as a potential course of action for other PAIBs who no longer wish to be associated with the employing organization. The respondent noted that this would be consistent with paragraph 100.24, which requires disassociation in the case of ethical conflicts.</p>	<p>although extreme – available to PAIBs who are not senior PAIBs. However, to be able to appropriately exercise such an extreme option, it would be necessary to presuppose that these other PAIBs would have been able to follow the same robust investigative and follow-up process as senior PAIBs. The Board believes that this would set an inappropriate expectation as to what these other PAIBs would be able to do in practice, given their more limited levels of authority and spheres of influence. The Board therefore determined not to suggest this as an option in Section 360.</p>
5.	<p>A respondent felt that it was unclear how the requirement for senior PAIBs to disclose NOCLAR to the external auditor would interrelate with the need to take any further action. The respondent suggested that if senior PAIBs become aware of the responses of the external auditors, they should take those into account when determining the need for further action.</p>	<p>The Board noted that disclosure of the matter to the external auditor and the latter’s response to it should not absolve the senior PAIB from his or her responsibility to determine the need for, and the nature and extent of, further action, given the responsibilities and expectations attached to a senior PAIB role. The Board therefore determined not to make a change in this regard.</p>
6.	<p>A respondent commented that senior PAIBs do not have the same professional public interest obligation as a practicing public accountant.</p>	<p>The Board noted that all PAs have a responsibility to act in the public interest under the Code even if they work in different roles and operate in different contexts. Also, as noted in paragraph 67 of the EM, the Board believes that senior PAIBs should have a greater responsibility to take action in response to identified or suspected NOCLAR than other PAIBs, given their decision-making ability and the expectations of them by virtue of their positions. This principle was widely supported during the NOCLAR roundtables. The Board therefore determined not to make a change in this regard.</p>

**Bounty Payments**

164. A respondent suggested that the Board should address whether it is appropriate for a PA to accept a bounty as a result of reporting NOCLAR under the proposals. The respondent was of the view that accepting such a bounty should be unethical. Another respondent suggested that the Code should describe the existence of bounty payments to whistle-blowers in some jurisdictions.



*IESBA Decision*

165. The Board noted that the ED (paragraphs 225.29 for auditors, 225.45 for other PAPPs, and 360.28 and 360.34 for PAIBs) already set out the overriding principle that when disclosing NOCLAR to an appropriate authority, PAs should act in good faith. Further, the Board noted that different jurisdictions may implement different incentives to encourage whistle-blowing, of which bounty payments are but one. The Board therefore determined that it would not be appropriate to focus on such payments.

**Recognizing Confidentiality as Being Also in the Public Interest**

166. A respondent noted that nowhere in the Code is there an acknowledgment that confidentiality, in and of itself, serves a public interest purpose in creating trust and facilitating open communication between PAs and their clients. The respondent suggested that the Board consider including such an acknowledgment in Section 140.

*IESBA Decision*

167. The Board accepted this suggestion but determined to broaden the acknowledgement to include PAIBs and their employing organizations (see paragraph 140.7).

**XXI. Effective Date**

168. The ED indicated that the Board intended to finalize the proposals using the extant structure and drafting conventions (“close-off” document) by the first half of 2016. It also indicated that the Board planned to restructure the close-off document using the new structure and drafting conventions being developed under the Structure of the Code project, and issue the restructured document as the final pronouncement. The Board therefore did not set an effective date at the time pending the restructuring work.

169. Subsequently, the Board determined to issue the final pronouncement using the extant structure and drafting conventions, without waiting for it to be restructured. The Board on further reflection recognized that there was some urgency in releasing the pronouncement given that it had taken over six years to be developed, and stakeholders were awaiting its issuance.

170. The Board considered making the pronouncement effective approximately 12 months after its anticipated date of issuance on the following basis:

- For auditors, effective for audits of financial statements for periods commencing on or after July 15, 2017.
- For other PAs in public practice and PAIBs, as of July 15, 2017.

171. After deliberation, the Board determined that the effective date for auditors should be at a point in time, like for all other PAs. The Board believes that from the perspective of the Code, it would not be appropriate to link the effective date to a financial reporting period because the provisions in the Code are about responding to NOCLAR or suspected NOCLAR when the auditor becomes aware of it, and not about whether the NOCLAR relates to a particular financial reporting period.

172. For example, the Board considered the case above with Section 225 becoming effective for audits of financial statements for periods commencing on or after July 15, 2017. In that situation, the Board was concerned that if information concerning the NOCLAR came to the auditor’s attention, say, on September 30, 2017 but the breach of law or regulation occurred in December 2016 and affected

only financial statements for periods ending on or before July 14, 2017, the auditor would not be required to respond to it because it was committed before the financial reporting period when Section 225 would become effective. The Board therefore determined that the effective date should be the same for all PAs: July 15, 2017. Under that effective date, the auditor would need to respond to any NOCLAR or suspected NOCLAR of which the auditor becomes aware from July 15, 2017 in accordance with Section 225, regardless of which financial reporting period might be affected.

173. Section 225 does not apply if the auditor was already aware of NOCLAR or suspected NOCLAR prior to the effective date. Early adoption of the provisions, however, is permitted. The same applies to other PAPPs and to PAIBs.
174. The objective of the IAASB's NOCLAR project is to address actual or perceived inconsistencies of the approach to identifying and dealing with instances of identified or suspected NOCLAR in complying with ISA 250 and other International Standards of the IAASB, including the scope of laws and regulations to be considered, when the Code also applies. The changes to the IAASB's International Standards are not expected to result in a change in practice or extension of procedures performed by auditors. This is because the amendments proposed by the IAASB merely clarify and highlight the auditor's responsibilities under law, regulation or relevant ethical requirements with respect to NOCLAR.

## NOCLAR Response Framework<sup>23</sup>

**NOCLAR:** Acts of omission or commission, intentional or unintentional, committed by a client [or by the professional accountant's (PA's) employing organization], or by those charged with governance (TCWG), by management or by other individuals working for or under the direction of a client [or the employing organization] which are contrary to the prevailing laws or regulations.

### Objectives – All Categories of PAs

In acting in the public interest:

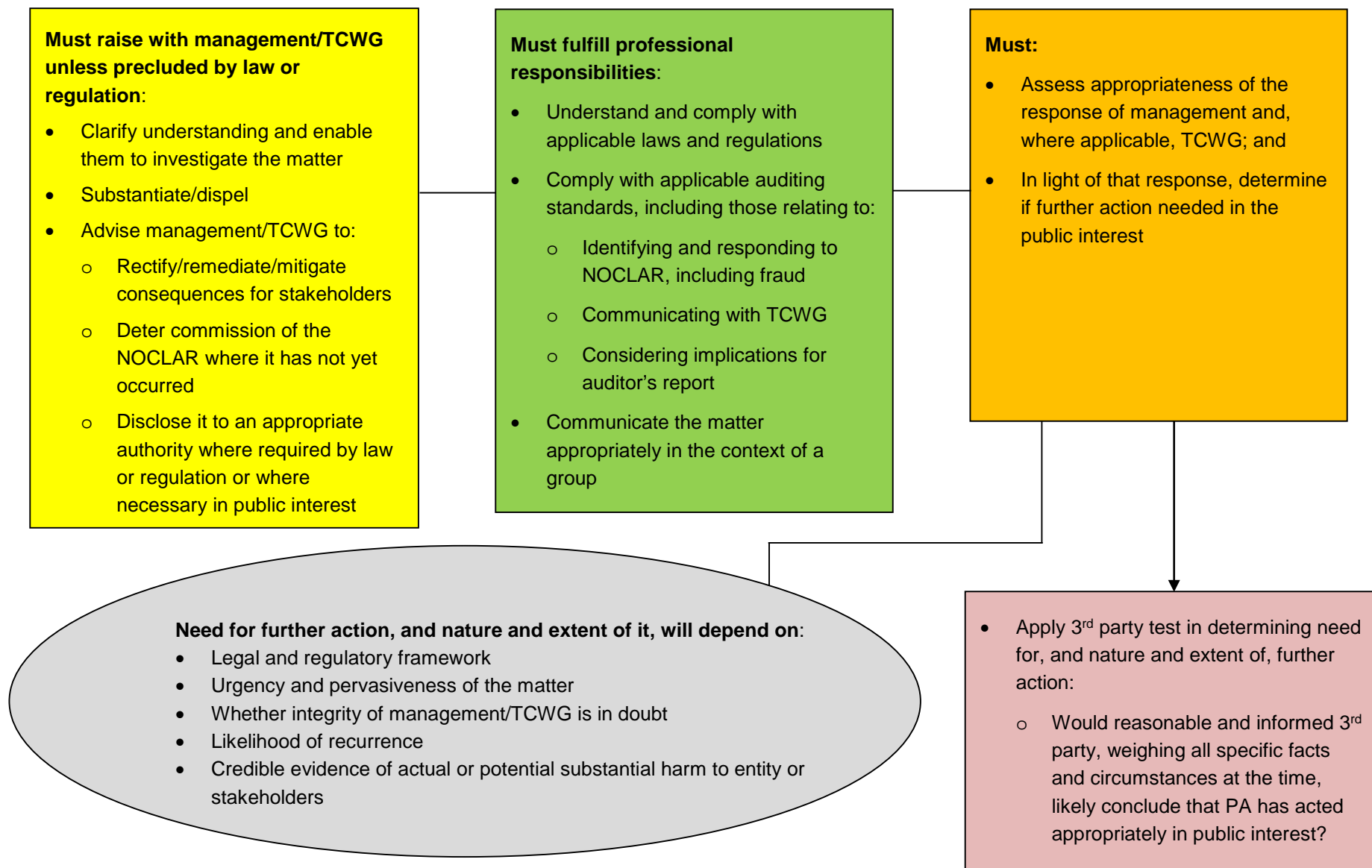
- To comply with the fundamental principles of integrity and professional behavior
- By alerting management or, where appropriate, TCWG, to seek to:
  - Enable them to rectify, remediate or mitigate the consequences of identified or suspected NOCLAR
  - Deter the commission of NOCLAR where it has not yet occurred
- To take such further action as appropriate in the public interest

### Scope of laws and regulations covered – All PAs

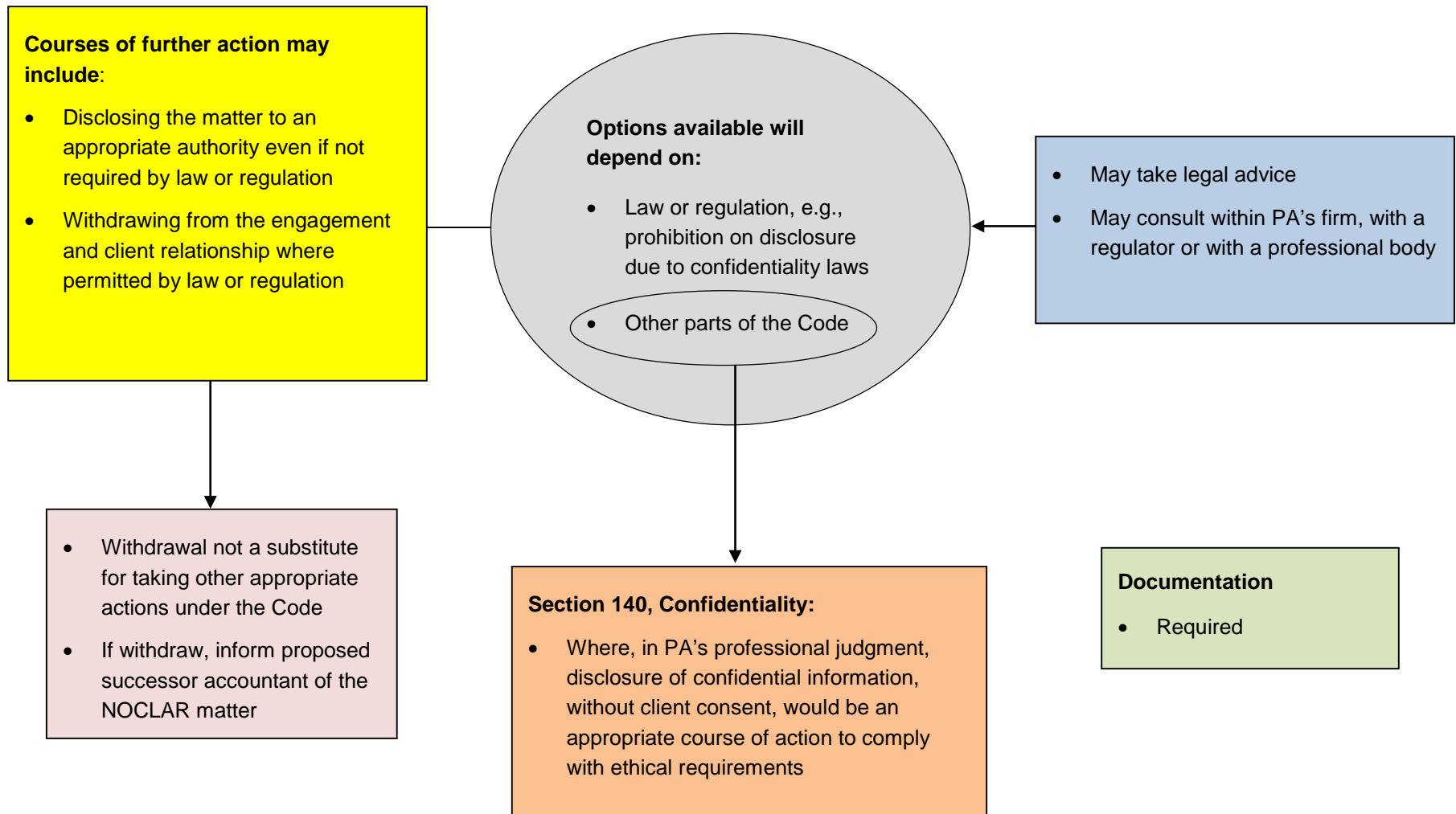
- Laws and regulations to which ISA 250 applies:
  - Laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements
  - Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the entity's business, to its ability to continue its business, or to avoid material penalties
- No distinction between public interest entities (PIEs) and entities that are not PIEs

<sup>23</sup> This diagram illustrates only the main elements of the response framework. It does not purport to be comprehensive. For details, reference should be made to the text of the pronouncement.

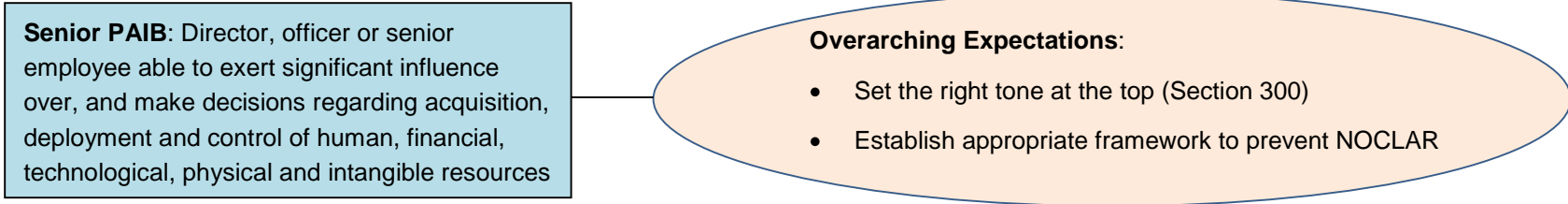
**AUDITORS – RESPONSES WHEN ENCOUNTERING OR BEING MADE AWARE OF NOCLAR OR SUSPECTED NOCLAR**



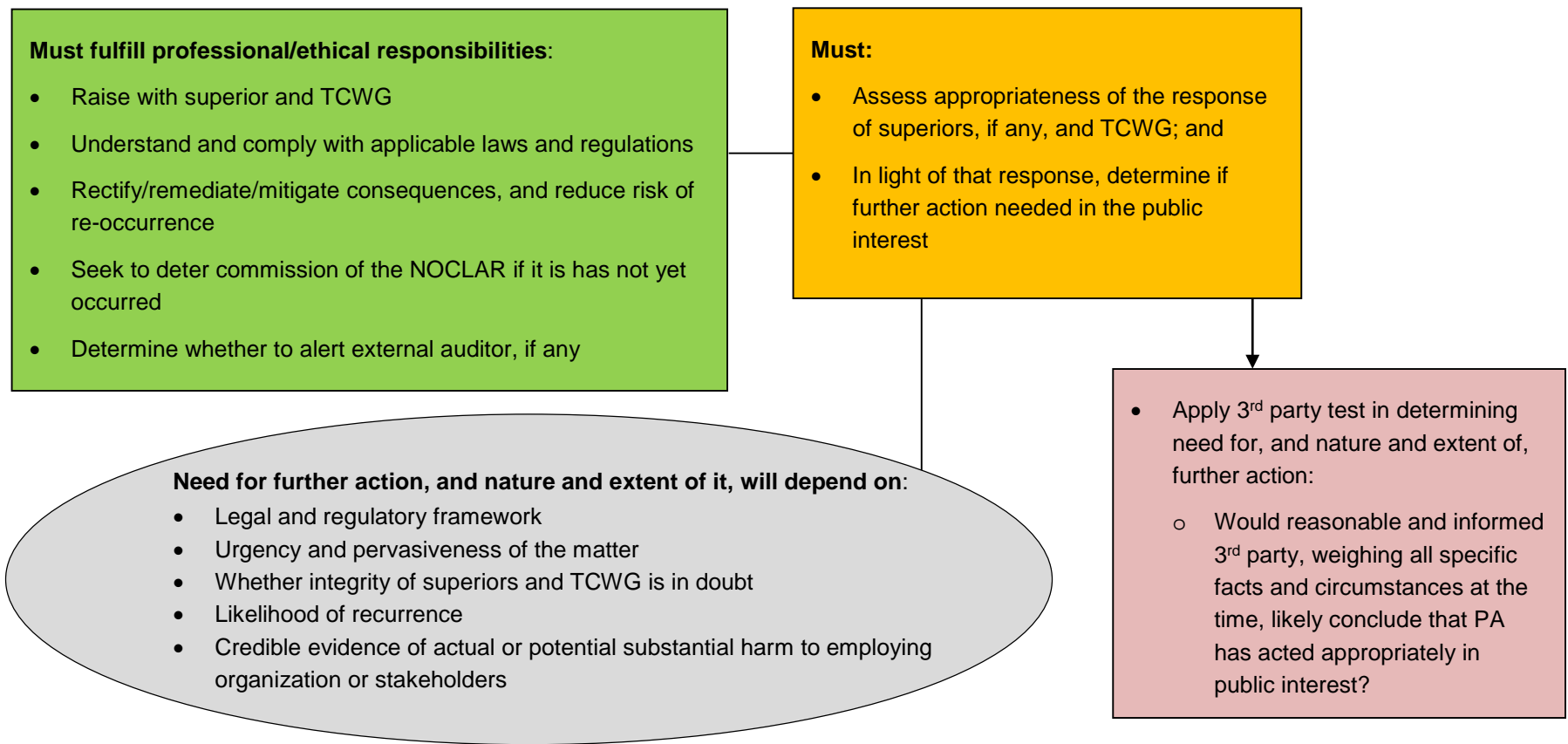
**AUDITORS – DETERMINATION OF FURTHER ACTION NEEDED**



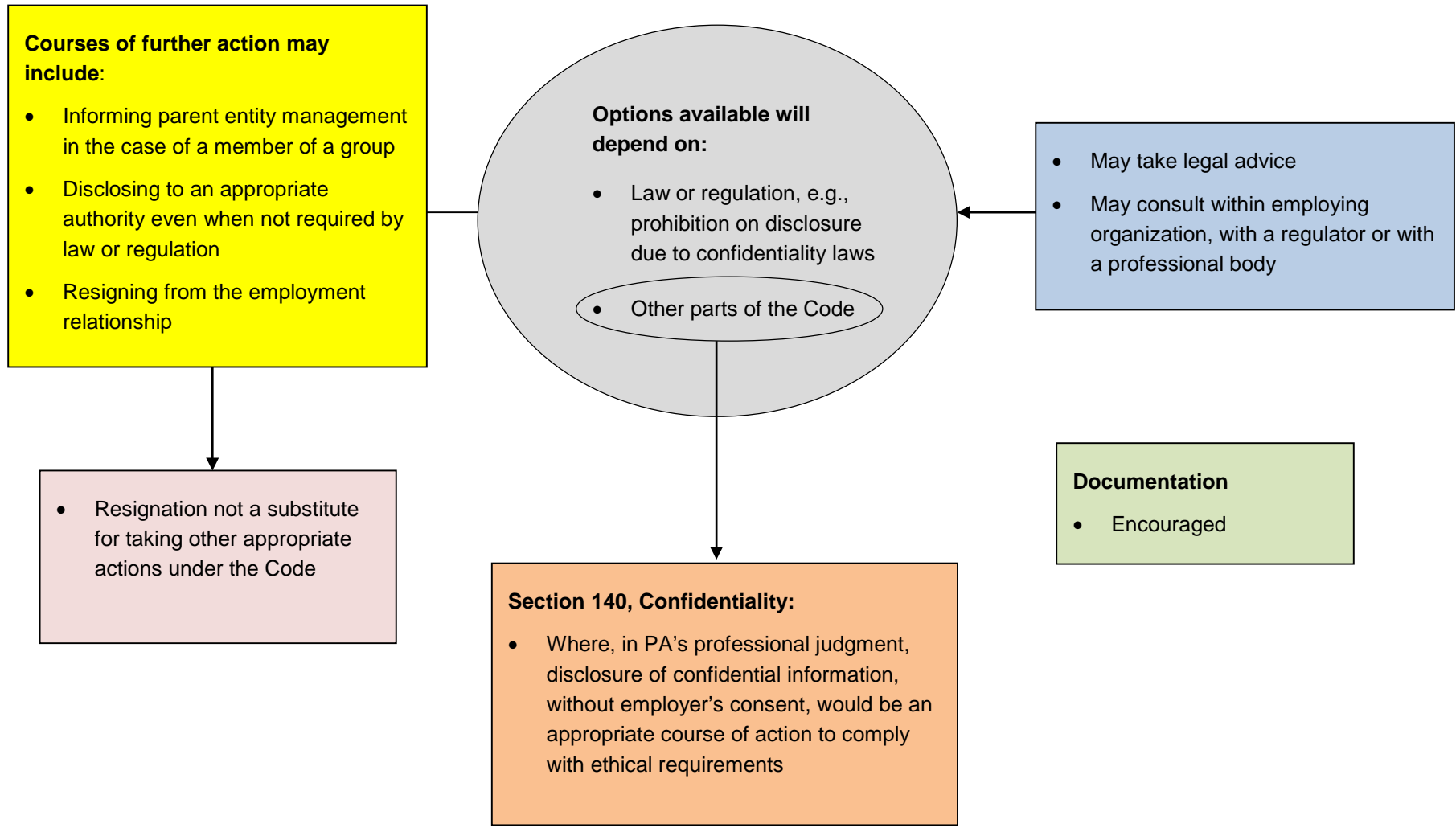
## SENIOR PAIBs



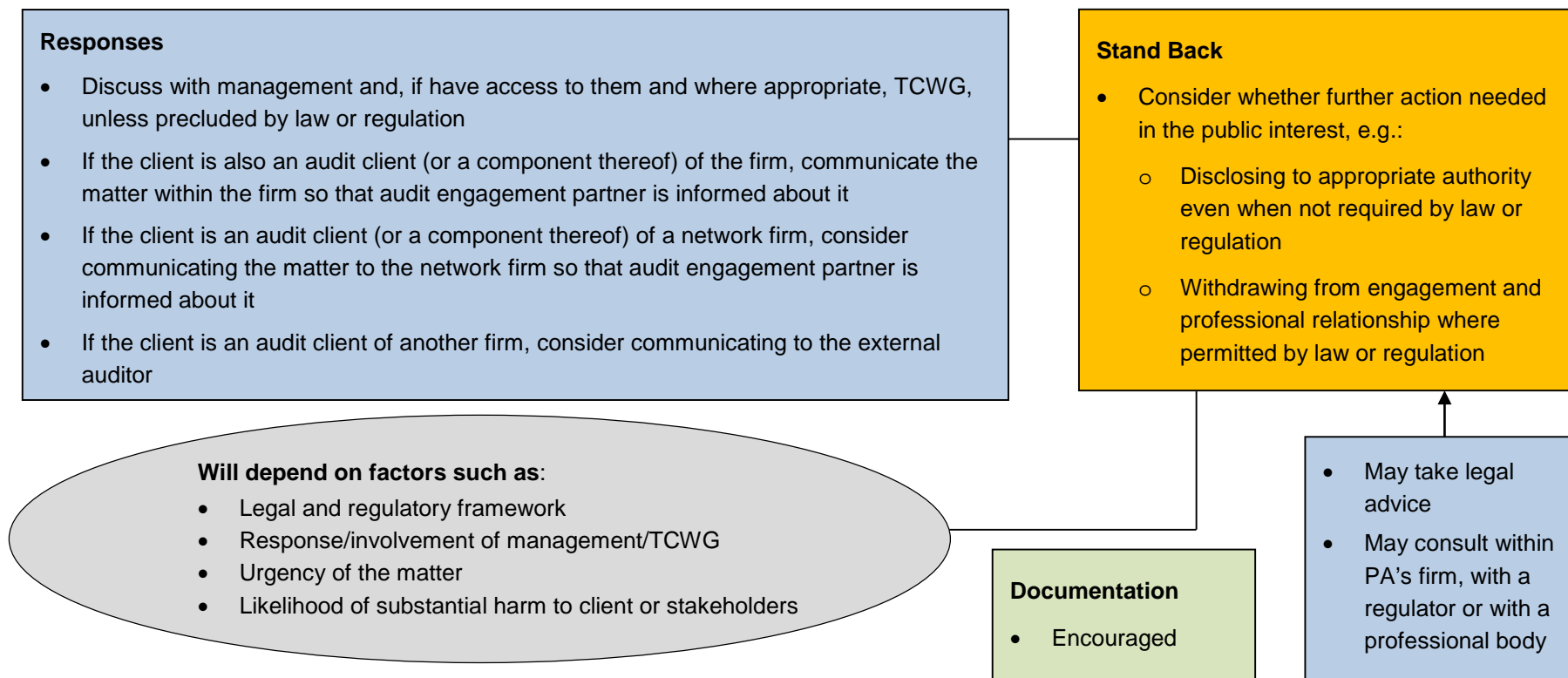
## RESPONSES WHEN ENCOUNTERING OR BEING MADE AWARE OF NOCLAR OR SUSPECTED NOCLAR



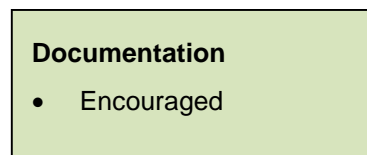
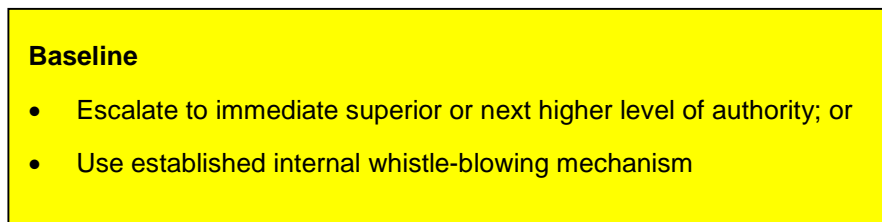
**SENIOR PAIBs – DETERMINATION OF FURTHER ACTION NEEDED**



**PAAs IN PUBLIC PRACTICE PROVIDING SERVICES OTHER THAN AUDITS**



**PAIBs OTHER THAN SENIOR PAIBs**





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