

**NOCLAR—Draft Minutes of the IESBA-related Part of the Joint March 2016
IESBA/IAASB CAG Session¹**

Mr. Fleck introduced the topic, highlighting the report-back in the agenda material regarding the September 2015 IESBA CAG discussion on the topic. IESBA CAG Representatives had no comments on the report-back.

Mr. Fleck then provided background to the project, recapping the journey traveled on this project since it was launched over six years ago. He outlined recent activities related to the project since the November/December 2015 IESBA meeting, including a meeting (jointly with IAASB representatives) with representatives of the Institut der Wirtschaftsprüfer (IDW) to listen to the IDW's concerns regarding the IESBA's and IAASB's NOCLAR-related proposals and to provide related explanations and clarifications. He highlighted the IESBA Task Force's intention to recommend that the IESBA commission the development of tools and resources to support implementation of the final NOCLAR proposals. He then summarized the tentative IESBA decisions on the project at the November/December 2015 IESBA meeting, and led Representatives through the matters for consideration.

The following matters were raised, among others.

GENERAL COMMENTS AND OBSERVATIONS

- Mr. Ahmed recognized the significant amount of hard work and challenging comments to address over the course of the project. He wondered about the observation from some respondents to the May 2015 IESBA NOCLAR Exposure Draft that it is not for Code to address NOCLAR but that this should be left to law or regulation to address. Mr. Fleck explained that some respondents share the view that the Code should mandate the disclosure of NOCLAR by professional accountants (PAs) to an appropriate authority, whereas other respondents believe that such disclosure matter should be left to law or regulation to address.
- Ms. McGeachy-Colby noted that the IFAC SMP Committee shared the same concerns as IDW regarding the potential for unintended consequences for audit quality as it felt that there was a de facto requirement to disclose NOCLAR to an appropriate authority under the proposals. She added that this is a very sensitive issue for SMPs. Mr. Siong explained why the Task Force did not share that concern.
- Mr. James highlighted that IOSCO Committee 1 was still considering the revised text. Accordingly, he noted that he would not be able to respond to all the matters presented for consideration during the session.

THIRD PARTY TEST

- Referring to comments from some respondents that the third party test is too subjective, Mr. James commented that his experience has been that such a test is challenging to enforce in a court of law with respect to auditor independence. He wondered what the IESBA's expectation was regarding enforceability by regulators in the context of NOCLAR. Mr. Fleck explained that the intention with respect to the Code is to inject an element of objectivity in the assessment of the particular matter at

¹ The draft minutes of the joint CAG session will be approved at the September 2016 IESBA CAG and IAASB CAG meetings.

hand from a hypothetical person's perspective. Regarding enforceability of the test, he commented that regulators will assess how the PA has applied the test. Accordingly, a well-documented reasoning will be an important consideration. He added that the test is intended to make sure that the PA is not making a subjective decision about the matter but thinking about how others would approach it.

- Mr. James expressed the view that it would behoove the IESBA to consider jurisdictions where the test might not be enforceable, and therefore consider whether the test is the right approach. He acknowledged that the PA will need to step back in assessing a NOCLAR matter. However, he expressed a concern that a regulator might not be able to enforce the test based on his experience in the U.S. Mr. Fleck agreed that the third party test would force the PA to step back in assessing the matter.
- Noting that he understood Mr. Fleck's explanation regarding the third party test, Mr. Rockwell expressed some doubt about the case law Mr. James mentioned. Mr. Rockwell noted that when cases involving auditors arise in the U.S., the test that has been applied is a strict liability test, which is a much stricter test than the third party test. He added that in most high profile cases of lawsuit against auditors, the test has been a strict liability test, not a reasonableness test. Accordingly, he was of the view that there is quite a bright line in U.S. case law.
- Mr. Ahmed commented that the third party test is akin to a "check and balance" mechanism. He noted the statements in the Code to the effect that the Code cannot override laws and regulations. He added that ISAs and the Code need to be addressed at the level of guiding principles to allow jurisdictions to implement specific laws and regulations. Accordingly, if the third party test were not enforceable in law or regulation, he wondered whether there would be a need to take a more general vs. specific approach. Mr. Fleck emphasized that in exercising appropriate professional judgment, the PA would need to take into account the national context.
- Mr. Hansen noted that NOCLAR is a most difficult topic; however, there is a need to address it. He was of the view that the key is appropriate balance as the process of finalizing the provisions could be neverending. He noted that there is already a public expectations gap regarding PAs' responsibilities vis-à-vis NOCLAR, and not addressing the topic would only widen that gap. He believed that the proposals would enhance the reputation of the profession.
- Mr. Stewart indicated that he understood the practical approach to introduce an objective evaluation of the need for, and extent of, further action in the response framework. He noted that in the International Financial Reporting Standards (IFRS), the approach is to think about the information needs of investors and other third party users, for example, taking into account a hypothetical market transaction when estimating fair values. While IFRS may have a different purpose, he noted that the notion of a third party test is not dissimilar in that context. Mr. Siong highlighted the IESBA's current efforts under its Safeguards project to provide further guidance regarding the test to facilitate its consistent application.
- Mr. Dalkin commented that the third party test is not a "foreign" concept for auditors, especially in the governmental context. Accordingly, he was of the view that it is a reasonable approach to take.

SCOPE OF MATTERS COVERED UNDER THE PROPOSED SECTIONS

Mr. Fleck explained the Task Force's proposed clarifications to the wording of the provisions addressing the scope of matters covered under the sections dealing with PAs in public practice and in business, pursuant to a comment from IOSCO Committee 1. Representatives broadly supported the Task Force's proposals and had no comment.

IMMINENT BREACH OF A LAW OR REGULATION

Mr. Fleck explained the proposed new provision in response to a comment from IOSCO Committee 1 that would permit a PA to effectively bypass the response framework in order to make disclosure to an appropriate authority in exceptional circumstances where the PA has reason to believe that an imminent breach of a law or regulation would cause substantial harm to stakeholders. Representatives broadly supported the proposal.

The following matters were raised:

- Mr. Thompson wondered if the third party test would still apply in these circumstances. Mr. Rockwell noted that it is a bypass of the process. Accordingly, one has to form a judgment regarding imminence and substantial harm. He wondered, however, whether this circumstance would also be subject to the documentation requirement.
- Mr. Waldron wondered whether the phrase "may exercise professional judgment" should be amended to read "shall exercise professional judgment." Mr. Fleck noted that the Task Force would reflect further on this suggestion.

COMMUNICATION WITH RESPECT TO GROUP AUDITS

Mr. Fleck explained the Task Force's proposals aimed at enhancing the provisions addressing communication with respect to group audits in response to feedback from IOSCO Committee 1. Representatives broadly supported the proposals.

The following matters were raised:

- Mr. Kockvedgaard noted that in some jurisdictions such as the EU, the audit committee at the parent entity is responsible for overseeing management of the entire group. He wondered whether such an audit committee would be covered under the concept of those charged with governance (TCWG) in the proposals. Mr. Fleck responded in the affirmative.

DOCUMENTATION BY PAS OTHER THAN AUDITORS

Mr. Fleck explained the Task Force's rationale for not taking up the suggestion from IOSCO Committee 1 to make the documentation provisions for PAs providing services other than audits of financial statements as strong as that for auditors. Representatives broadly supported the Task Force's and the IESBA's views on this matter and had no comments.

COMMUNICATION BETWEEN PREDECESSOR AND PROPOSED SUCCESSOR AUDITORS

Mr. Fleck explained the Task Force's proposal, in response to a comment from IOSCO Committee 1, regarding not requiring client consent as a precondition for communication between a predecessor auditor

and a proposed successor auditor in circumstances where there has been a change of auditors as a result of a NOCLAR matter. Representatives broadly supported the proposal and had no comment.

CONCLUDING REMARKS

Dr. Thomadakis noted that the constructive discussion had reinforced his conviction that the IESBA must complete the project. In this regard, he noted the importance of concluding whether the project had achieved an appropriate balance between the public interest objective and the need to have regard to the global application of the Code. He observed that many jurisdictions already have legal or regulatory reporting requirements and that the IESBA had taken care that the provisions in the Code not conflict with those requirements. However, the proposed provisions also represented a step forward for jurisdictions that do not currently have a requirement in law or regulation to report NOCLAR. He acknowledged that there still remains a range of views regarding the nature and extent of PAs' responsibilities in the Code for responding to NOCLAR, hence why the exercise of professional judgment would be critical and why the guidance the Code will provide would be so valuable.

Dr. Thomadakis added that in some respects, the provisions would be breaking new ground. Accordingly, the IESBA intended to review the effectiveness of application of the provisions post-implementation. Ultimately, he noted the need to fill a gap where laws and regulations do not address PAs' response to NOCLAR. Ms. Elliott agreed, noting that it would be important to review experience post-implementation, and that the IESBA should be prepared to revisit the provisions if it appears that they are not working as effectively as intended. Mr. van der Ende concurred with Dr. Thomadakis, noting the support of the proposals from the Basel Committee on Banking Supervision.

WAY FORWARD

Mr. Fleck outlined the next steps in the project, noting that final approval of the provisions was planned for the latter part of April 2016, subject to the deliberations of the IAASB regarding consequential and conforming amendments to its standards as a result of the IESBA's NOCLAR proposals.