

**NOCLAR—Draft Minutes of the March 2016 IESBA Meeting**

Mr. Fleck introduced the topic, providing background to the project and highlighting its key objective and the strengths of the proposed response framework. He paid tribute to the former Task Force Chair, Caroline Gardner, for taking the project forward since the issuance of the May 2015 Exposure Draft. He briefly reported on recent activities related to the project, including: liaison with the IAASB Task Force; liaison with the Structure Task Force in relation to development of a preliminary draft of the restructured Sections 225 and 360;<sup>1</sup> and outreach to a number of stakeholders, including the Institut der Wirtschaftsprüfer (IDW). He noted that there remain diverse views on a number of the issues in the project, even if there is widespread expectation among stakeholders that the project will be finalized soon. He highlighted the key concerns from the IFAC SMP Committee on the proposals. He also highlighted the key outcomes of the discussion with the joint IESBA and IAASB CAGs the previous week. Among other matters, he had taken the opportunity to flag to both CAGs that the Board would plan to keep the topic under review post-implementation and to consider commissioning support tools and resources to facilitate implementation.

Commenting in his capacity as a smaller practitioner, IFAC SMP Committee liaison Mr. Caswell observed that the provision of audit and other services by SMPs to their clients has blurred the concept of an independent auditor. Often, a report of alleged wrongdoing will go directly to the owner-manager of the entity. There is a concern that if there is an expectation that a smaller practitioner will disclose identified or suspected NOCLAR to an appropriate authority, this will shut off the flow of information from the client. He noted that he does not hold that view and believed that the Board has struck the appropriate balance in the proposals.

Mr. Koltvedgaard expressed the view that the Board has come to the right conclusion regarding the inclusion of a third party test in the response framework, noting that the two CAGs were overall supportive of including the test.

Mr. Fleck then led the Board through the matters for consideration, including the proposed changes to the text.

**IMMINENT BREACH OF A LAW OR REGULATION**

Mr. Fleck explained the proposed new provision, in response to a comment from IOSCO Committee 1, which would permit a professional accountant (PA) to effectively bypass the response framework in order to make disclosure to an appropriate authority. This would be 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.

In broadly supporting the proposal, IESBA members raised the following matters, among others:

- In Italy, criminal law imposes a duty to stop an imminent crime by reporting it. Failure by an individual to make such a report in these circumstances could lead the individual being deemed to have actually committed the crime.

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<sup>1</sup> Proposed Section 225, *Responding to Non-Compliance with Laws and Regulations*; and proposed Section 360, *Responding to Non-Compliance with Laws and Regulations*

- As the provision is intended to apply in exceptional circumstances where the alternative of non-disclosure would mean potentially disastrous consequences, this should be made clear. Otherwise, the response process which imposes appropriate due diligence would serve little purpose.
- The exercise of professional judgment in these circumstances should not be optional. Accordingly, the PA should be *required* to exercise professional judgment.
- Consideration should be given to whether:
  - A term other than “substantial harm” should be used to better differentiate this circumstance from other circumstances that would be addressed through the normal response process.
  - The provision would be better placed earlier in the response process rather than at the end of it.
  - The client should be notified about the PA’s intent to make disclosure before such disclosure is made.
- As an alternative to the PA making disclosure in these circumstances, it may be easier to alert management or those charged with governance (TCWG) to the imminent breach of the particular law or regulation in order to prevent the breach. However, in building this into the provision, care should be taken not to trigger the entire response process.

An IESBA member commented that the provision would require the exercise of much professional judgment, given concepts such as “reason to believe” and “substantial harm.” Accordingly, the IESBA member was of the view that there could be a problem of hindsight judgment where PAs could be held liable for failing to fulfill their duty. Mr. Fleck responded that this is why so much importance is attached to documentation of the facts and circumstances, and the PA’s assessments and rationale for any action taken. He emphasized that documentation would be a critical defense against such hindsight judgment. He added that the importance of documentation could be emphasized in implementation support material. Another IESBA member agreed that implementation support material will be important and that such material would provide an opportunity to remind users of the Code and other stakeholders of the objectives of the pronouncement once it is finalized.

The IESBA asked the Task Force to reflect on the above comments in refining the text.

#### 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.

In broadly supporting the proposals, IESBA members raised the following matters, among others:

- Besides the downstream communication of the identified or suspected NOCLAR from the group engagement partner to those performing work at components for group audit purposes, consideration should be given to the group engagement partner also communicating the matter downstream to auditors of components whose financial statements are subject to audit for purposes other than a group audit (for example, a statutory audit).
- Consideration should be given to the practicality of the statutory auditor of a component disclosing the matter upstream to the group engagement partner, as in many cases these components are very small entities.

- ISAs deal with communications within a group. However, the overriding principle should be that the auditor expressing the opinion on the financial statements should have all the information necessary in order to issue the auditor's report.

The IESBA asked the Task Force to reflect on the above comments.

#### COMMUNICATION BETWEEN EXISTING AND PROPOSED 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 an existing auditor and a proposed auditor where the former is withdrawing from the professional relationship as a result of a NOCLAR matter.

In broadly supporting the proposals, IESBA members raised the following matters, among others:

- Consideration should be given to requiring the proposed successor auditor to request information from the predecessor auditor. If the former is unable to obtain the information from the latter, this would be a red flag. It was noted that in the U.S., the onus is on the proposed successor auditor to contact the predecessor auditor.
- References to successor auditor should be to "proposed successor auditor" as the firm has not yet accepted the appointment.

The IESBA asked the Task Force to reflect on the above comments.

#### FORENSIC ENGAGEMENTS

Referring to the last bullet point of the guidance in paragraph 225.49, an IESBA member wondered whether it was sufficiently clear that disclosure of identified or suspected NOCLAR to an appropriate authority would not be made in the case of forensic engagements. The IESBA member noted a concern that clients may not engage PAs to investigate potential non-compliance within the entity if they felt that PAs would be expected to disclose such non-compliance to an appropriate authority. Several IESBA members were of the view that it would not be appropriate for the Code to prohibit PAs from making disclosure pursuant to complying with Section 225. It was noted that whether or not a forensic accountant would make disclosure would be a matter of professional judgment. While disclosure may not be warranted in the early part of an investigation, it may become a consideration towards the end of the investigation if the identified or suspected NOCLAR is a major issue and management or TCWG have not appropriately responded to the matter. After further deliberation, the IESBA agreed to maintain the current approach of keeping disclosure to an appropriate authority as a possible course of further action that may be considered.

#### OTHER MATTERS

In addition editorial matters, IESBA members suggested the following for the Task Force's consideration:

- Whether the phrase "comes across" is too casual, especially given that the text also uses a different formulation ("becoming aware").
- Whether the concept of "substantial harm" should encompass consideration of the consequences to the client, given that paragraph 8 (which scopes out matters that are clearly inconsequential) refers to consequences to the client.

- Whether the factors to take into account in considering whether to disclose NOCLAR or suspected NOCLAR to an appropriate authority for PAs providing a non-audit service should include other factors listed for PAs performing audits of financial statements.
- Reconsidering the wording of the documentation provision for senior PAIBs, as they may not themselves carry out the documentation but may arrange for others to do so.

#### PRELIMINARY RESTRUCTURED TEXT

Mr. Thomson, Chair of the Structure Task Force, noted that his Task Force has been working closely with the NOCLAR Task Force in developing the preliminary restructured text. He was of the view that the draft restructured text was generally consistent with the proposed structure and drafting conventions. Accordingly, he was broadly comfortable with the work that had been carried out.

IESBA members broadly supported the direction of the preliminary restructured text and offered editorial suggestions for the NOCLAR Task Force's consideration. It was also suggested that consideration be given to whether some of the flow of the narrative has been lost as a result of relocating some of the contextual material to be more upfront in the document.

An IESBA member wondered about the appropriateness of including the banner containing the statement "The Conceptual Framework contained in Section 120 applies in all circumstances" at the top of every page of the document. It was noted that this could give rise to potential confusion as there appears to be nothing in Sections 225 and 360 that relate to the conceptual framework. Mr. Thomson noted that the matter of including the banner at the top of each page of every section of the Code will be further considered by the Structure Task Force.

#### EFFECTIVE DATE AND ROLL-OUT

Dr. Thomadakis reminded the Board of its previous decision to issue the NOCLAR pronouncement under the extant structure and drafting conventions once finalized, and subject to PIOB approval of due process, without waiting for the document to be restructured. Mr. Fleck then outlined the Task Force's proposal regarding the effective date of the proposed pronouncement.

An IESBA member commented that the proposed effective dates with respect to auditors and other PAs appeared tight, given the need to raise awareness among preparers, TCWG and other stakeholders who might be affected by the provisions. Mr. Fleck noted that the project has long been on the Board's agenda and been well publicized. Dr. Thomadakis observed that there has also been extensive stakeholder outreach on the project. Mr. Siong indicated that appropriate public communications will be issued to raise awareness once the Board approves the final pronouncement. Mr. Gunn added that unlike the ISAs, the proposed provisions are not a performance standard. Accordingly, there is less of a need for significant lead time to prepare for implementation.

An IESBA member suggested that IFAC member bodies be encouraged to adopt the new pronouncement so that they can appropriately promote it. Mr. Siong noted that staff will be discussing possible initiatives with the communications department within IFAC to roll out the new pronouncement once issued.

An IESBA member questioned the need to link the effective date for auditors to a financial reporting period, as this could result in auditors not responding to NOCLAR or suspected NOCLAR of which they have become aware if the non-compliance was committed after the end of that particular financial reporting

period. After deliberation, the IESBA agreed that both Sections 225 and 360 should be effective 12 months after the anticipated date of issuance of the final pronouncement, i.e., effective as of July 15, 2017.

#### AGREEMENT IN PRINCIPLE

After agreeing the changes to the document in the light of the Board discussion, the Board agreed in principle to close off its deliberations on the document, subject to the deliberations of the IAASB on related consequential and conforming amendments to the IAASB's standards. These deliberations were of particular relevance to the way that the provisions relating to communications between auditors of entities within a group are to be expressed, including the terminology used, as the IAASB has an initiative considering potential changes to ISA 600.<sup>2</sup> Mr. Fleck then outlined the next steps for the project.

Dr. Thomadakis conveyed the Board's appreciation to Mr. Fleck and the previous Task Force Chair, Caroline Gardner, as well as all previous Task Force members, for their contributions in bringing the project to this stage.

#### WAY FORWARD

The Board agreed to meet via teleconference on April 25, 2016 to consider the outcome of the IAASB's deliberations and any related proposed changes to the close-off text with a view to voting out the final pronouncement.

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<sup>2</sup> ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*