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International Organization of Securities Commissions
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6 November 2015

Technical Director
International Ethics Standards Board for Accountants
545 Fifth Avenue, 14th Floor
New York, NY 10017 U.S.A.

Our Ref: 2015/JE/C1/IESBA/76

**Subject Line: IESBA's Exposure Draft, *Responding to Non-Compliance with Laws and Regulations***

Dear Sir:

The International Organization of Securities Commissions' Committee on Issuer Accounting, Audit and Disclosure (Committee 1) appreciates the opportunity to comment on the International Ethics Standards Board for Accountants' (the IESBA or the Board) Exposure Draft, *Responding to Non-Compliance with Laws and Regulations* (the Paper). As an international organization of securities regulators representing the public interest, IOSCO is committed to enhancing the integrity of international markets through the promotion of high quality accounting, auditing and professional standards, and other pronouncements and statements.

Members of Committee 1 seek to further IOSCO's mission through thoughtful consideration of accounting, disclosure and auditing concerns, and pursuit of improved global financial reporting. Unless otherwise noted, the comments we have provided herein reflect a general consensus among the members of Committee 1. Our comments are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.



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**Overall Comments**

We support the Board's continued efforts to develop enhancements to the Code to help guide professional accountants in how best to respond in the public interest when encountering a non-compliance or suspected non-compliance with laws and regulations (NOCLAR). We appreciate the general direction of the model proposed in the Paper but we think that the Board needs to address some aspects of the Proposal during its re-deliberations as it was not always clear to us what the Board had proposed. We have developed almost all of our comments with respect to professional accountants who serve as auditors; nonetheless, we encourage the Board to apply the concepts inherent in them to other professional accountants as appropriate in the public interest.

We note and appreciate the provision that relieves a professional accountant from the duty of confidentiality should the accountant determine that disclosure of the matter to an appropriate public authority is the right course of action to take. The possibility of incorporating a provision into the Code that provided this relief was the central reason that IOSCO had raised with the IESBA the possibility of revisiting the NOCLAR provisions of the Code. Nonetheless, in finalizing this provision we ask the Board to review the manner in which it would function within the Code. Specifically, what would be the interaction between the Paper's proposed course of action that the professional accountant would undertake upon encountering a NOCLAR and relief from the Code's confidentiality provision? Would undertaking the proposed course of action be a prerequisite to this relief or rather is relief automatic, such that a professional accountant may legitimately report a NOCLAR to a public authority without completing the described course of action? If the latter, then is the course of action proposed in the Paper intended to serve as the maximum that the Code would call upon a professional accountant to do as a matter of serving in the profession, rather than as the minimum needed to avoid breaching the Code's provision on confidentiality?

We are not sure of the Board's intent for this matter because the language in par. 225.29, which states "If the professional accountant determines that disclosure of the matter to an appropriate authority is an appropriate course of action in the circumstances, this will not be considered a breach of the duty of confidentiality under Section 140 of this Code", is placed after the results of the proposed course of action for the professional accountant. We believe the Board should make it clear that under the Code an accountant is always free to make disclosure to an appropriate authority. We don't want a scenario in which, for example, management or TCWG are unwilling to speak with the professional accountant about a



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NOCLAR and as a result either the professional accountant or others believe that having not completed this step he or she cannot report a NOCLAR to a public authority.

**Scope**

With respect to NOCLAR that a professional accountant may come across in the course of providing a professional service, we note that paragraph 225.5 of the Paper addresses:

> "(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 [emphasis added]."

This, in effect, establishes as the starting point for the scope of this section of the Code NOCLAR matters that are "material" or "fundamental" in nature, as described. Considering this, we find it challenging to understand the purpose of paragraph 225.8 that proceeds to then scope out matters that are "clearly inconsequential." Is the Board suggesting that matters in paragraph 225.5 could be inconsequential? We believe the Board should re-examine the interactions of its scoping distinctions. Once the Board's intention is clearer to us we may have more comments on this section of the Paper.

**Professional Accountant's Compliance with Applicable Laws and Regulations**

We note that the Paper addresses in two places the professional accountant's responsibilities to comply with any laws, regulations and/or professional standards that apply to its handling and/or disclosure to a third party of a NOCLAR. While we support the direction of these provisions, we ask the Board to revisit their placement and their drafting.

With regard to placement, we note that these provisions are placed both in an overarching manner at the beginning of the Paper (par. 225.10) as well as within the section on addressing the matter with management and TCWG (par. 225.17). Why are these provisions contained in two places? If the Board concludes that they need to be included in more than one place,



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then we recommend that they also be added to the section on determining whether to disclose the matter to an appropriate authority (par. 225.27 onwards).

With regard to drafting, we note that the guidance in the overarching provision is written more narrowly than that of the section on addressing the matter with management and TCWG. This is because the overarching provisions refer to the professional accountant's compliance with laws and regulations but not with professional standards, while the section on addressing the matter with management and TCWG also invokes compliance with the accountant's professional standards. Why does the content differ?

**Addressing a NOCLAR Matter with Management and Those Charged with Governance**

*Significant Shareholders*

We are unclear of the Board's intentions with respect to the professional accountant's potential interaction with sizable shareholders who have the ability to compel management to take appropriate action with respect to a NOCLAR. We presume that the Board considers TCWG to likely include representatives of such shareholders, and thus the professional accountant would address the NOCLAR with such representatives as part of its consultations with management and TCWG. However, if this presumption is erroneous then we believe it will be appropriate for the Board to include language in the provisions advising the professional accountant to discuss the NOCLAR with such shareholders. This provision should be effected with due regard for compliance with laws or regulations governing the ability to use this information.

*"Prompting" Management*

We note that in par. 225.17 the Paper states that:

> "If management and, where appropriate, those charged with governance agree that non-compliance has occurred or may occur, the professional accountant shall prompt them to take appropriate and timely actions, if they have not already done so..."

We encourage the Board to avoid requiring the auditor to "prompt" management and, where appropriate, those charged with governance to take action as this could be interpreted as partaking in the management of the resolution of the matter. Perhaps instead a term such as to



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"inform" or "ask" management and, where appropriate, those charged with governance about taking appropriate and timely actions would be better.

*Compliance with Professional Standards*

We believe the Paper should clearly articulate that the lead audit engagement team should be notified in all cases when a NOCLAR arises in any jurisdiction during the performance of an audit or a non-audit service at a component.

In addition, we believe that it would be helpful to enhance the focus on the difficulties arising for auditors when faced with a group audit situation, whether all of the auditors involved belong to the same network or not.

**Determining Whether Further Action by the Professional Accountant is Needed**

*The Model for Determination*

In light of the significant public interest implications of the professional accountant not taking further action when needed, the "expectations of a reasonable and informed third party" test seems to be an amenable solution to the issue of determining the need for further action by the professional accountant, in lieu of a better alternative being identified by the Board. As such, we suggest that the Board emphasizes that the reasonable and informed third party test found in paragraph 225.25 is intended to be a "step-back" provision, by which the professional accountant tests its analysis regarding the need for further action in light of the specific facts and circumstances. Nonetheless, we read the Paper to suggest that the proposed role of this third party test is (solely) to assist the professional accountant in determining the appropriate nature and extent of, versus the need for, its action.

*Consultation with Others*

We support the reference to the fact that consideration of a NOCLAR may involve complex analysis and judgments, and thus appropriate consultation by the professional accountant is key to the appropriate resolution of the matter. This reference is contained in paragraph 225.26, which mentions possible external parties with whom the professional accountant might consult. We suggest mentioning in this paragraph or elsewhere that the duties of the



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professional accountant under the ISAs would also involve consulting internally, that is, within his or her own firm.

**Documentation**

*"Significant Matters" Filter*

We believe that the documentation provision in paragraph 225.32 of the Paper inadvertently introduces a "significant matters" filter that is not appropriate. As was mentioned earlier in our letter, the auditor's starting point appears to be matters that are "material" and "fundamental." However, the current construct of paragraph 225.32 suggests that some material or fundamental matters may not be significant and therefore the professional accountant is not required to document its work related to them. Is the Board suggesting that the accountants work with respect to some material or fundamental matters would not be documented? We believe the documentation requirements should be consistent with the scope.

*Documentation by Other than Professional Accountants in Public Practice*

While we agree with the provision that requires auditors to document a NOCLAR matter, subject to our comments above, we believe it would be prudent for other professional accountants who are not auditors to have a similarly strong provision to document appropriate NOCLAR matters. While it may not currently be common practice to document, we believe the significance of the NOCLAR being addressed by the Paper could be subject to legal proceedings and as such a well-documented account of the NOCLAR could help establish the key decisions and positions taken by the professional accountant.

**Changes in Professional Appointment**

We note that the Explanatory Memorandum within the Paper states that:

> "A regulatory respondent to the ED had recommended that the Board consider requiring the predecessor auditor to notify a successor auditor of the matter so that the latter understands the risk of accepting the engagement. The Board recognized the potential benefits through mandating this communication in the Code. In particular, this could more effectively lead to desired outcomes in the public interest in terms of stimulating



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appropriate actions by management or TCWG to respond to the NOCLAR or suspected NOCLAR. Importantly, knowledge that such a communication requirement exists could have the effect of ensuring that management and TCWG respond appropriately. "

In addition, section 210:11 of the Code states that:

"An existing accountant is bound by confidentiality. Whether that professional accountant is permitted or required to discuss the affairs of a client with a proposed accountant will depend on the nature of the engagement and on:

(a) Whether the client's permission to do so has been obtained; or

(b) The legal or ethical requirements relating to such communications and disclosure, which may vary by jurisdiction."

In this regard, the Board has proposed to include the following language in section 210.13:

"In the case of an audit of financial statements, a professional accountant shall request the existing accountant to provide known information regarding any facts or circumstances that, in the existing accountant's opinion, the proposed accountant needs to be aware of before deciding whether to accept the engagement. If the client consents to the existing accountant disclosing any such facts or circumstances to the proposed accountant, the existing accountant shall provide the information honestly and unambiguously. If the client fails or refuses to grant the existing accountant permission to discuss the client's affairs with the proposed accountant, the existing accountant shall disclose this fact to the proposed accountant, who shall carefully consider such failure or refusal when determining whether or not to accept the appointment."

While we appreciate the Board's acknowledgement of the benefits of requiring the predecessor auditor to inform the successor auditor of any NOCLAR, we are concerned that instead of including a requirement that compels the predecessor to communicate NOCLAR to the successor auditor, sections 210.11 and 210.13 of the Code allows the notion of "confidentiality" to be used as a reason to restrict the communication of NOCLAR between predecessor and successor auditors.



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Consistent with our letter dated 22 January 2013, we believe the Code and its professional obligations of auditors should be reconsidered with respect to balancing the auditors' obligations for confidentiality to the entity it is auditing and its duties in serving the public interest with respect to the handling of NOCLAR. We believe this is also applicable to sections 210.11 and 210.13 of the Paper. We believe confidentiality should not be a mechanism to restrict the predecessor auditor's public-interest obligation to inform a successor auditor of known information regarding the facts and circumstances of a NOCLAR and in this regard we encourage the Board to reconsider its proposal in this area. Moreover, we believe that the predecessor auditor should disclose a NOCLAR to the successor auditor unless confidentiality requirements founded in laws and regulations prevent him from doing so.

In addition, we believe that prior to the predecessor auditor discussing a NOCLAR with the successor auditor, it is appropriate for the predecessor to inform the client of the intention to discuss the matter rather than requiring the predecessor to obtain the client's permission as outlined in paragraphs 210.11-210.13.

Further, we note that the Paper is silent with respect to changes in the professional appointment of the auditor specifically when the existing auditor does not, or refuses to, provide information regarding any facts or circumstances [regarding NOCLAR] even when allowed by the client. We believe the Board should provide guidance for such situations in section 210.13 of the Paper.

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Thank you for the opportunity to comment on the Paper. If you have any questions or would like to further discuss these matters, please contact either Nigel James or me at 202-551-5300.

Sincerely,

Julie A. Erhardt /SF

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