

8 September 2015

Mr. Ken Siong
Technical Director
International Ethics Standards Board for Accountants (IESBA)
International Federation of Accountants (IFAC)
545 Fifth Avenue, 14th Floor
New York, New York 10017 USA
By email: kensiong@ethicsboard.org

Dear Mr. Siong,

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

Accounting Professional & Ethical Standards Board Limited (APESB) welcomes the opportunity to make a submission on IESBA's Exposure Draft *Responding to Non-Compliance with Laws and Regulations* (NOCLAR ED).

APESB's role

APESB is governed by an independent board of directors whose primary objective is to develop and issue, in the public interest, high-quality professional and ethical pronouncements. These pronouncements apply to the membership of the three major Australian professional accounting bodies (CPA Australia, Chartered Accountants Australia and New Zealand and the Institute of Public Accountants). In Australia, APESB issues APES 110 *Code of Ethics for Professional Accountants* which includes the auditor independence requirements as well as a range of professional & ethical standards that deal with non-assurance services.

Introductory comments

APESB commends IESBA on its consideration of stakeholders' feedback from the initial 2012 exposure draft, and its extensive global consultation and outreach activities undertaken in the development process of this second ED.

In developing APESB's response to this NOCLAR ED, we have taken into consideration Australian stakeholders' feedback from two roundtable events conducted by APESB in Melbourne and Sydney in July 2015 as well as submissions from stakeholders.

We acknowledge that we have had the opportunity to review the New Zealand Auditing and Assurance Standards Board's (NZAuASB) submission. We are supportive of NZAuASB's submission subject to the comments within this submission.

APESB has prepared responses to IESBA's general and specific questions in Appendix A.

APESB is supportive of IESBA's proposed framework for professional accountants (PAs) to address instances of identified or suspected acts of NOCLAR subject to the recommendations noted below.

Recommendations

APESB's key recommendations for IESBA's consideration are:

- the scope of laws and regulations should be amended from “financial statements” to “financial statements and other underlying subject matter” to address subject matter other than financial statements;
- the auditor's NOCLAR framework should encompass reviews of financial statements in a similar manner to the scope of section 290 of the Code;
- the examples of laws and regulations should be categorized according to matters that are likely to be within the subject matter expertise of PAs and matters on which the PA is likely to only have a general knowledge;
- the examples of laws and regulations should also include data protection and privacy legislation;
- the specific legal or regulatory requirement to report to an appropriate authority should apply in an equal manner in all four frameworks;
- the auditor's framework should include explicit guidance in respect of the action an auditor should take upon receipt of information from other PAs in public practice or senior PAIBs regarding an identified or suspected NOCLAR;
- there should be an explicit scope exclusion for insolvency appointments that are subject to legislation in the relevant jurisdiction;
- consider the development of case studies to illustrate the application of the NOCLAR framework in different scenarios in a similar manner to IESBA's development of network firm examples.;
- the professional obligation for a professional accountant in public practice to report an identified or suspected NOCLAR to the audit engagement partner of the firm should be equally applicable when the client is an audit client of a network firm;
- in addition to the physical safety of a PA, their psychological wellbeing, and professional reputation should also be considerations when determining whether to report an identified or suspected NOCLAR to an appropriate authority;
- in circumstances where a PA is considering disclosing a matter to an appropriate authority, other PAs in public practice and the senior PAIB should also document in a similar manner to the auditor; and
- in circumstances where a PA has reported an identified or suspected NOCLAR to an appropriate authority, IESBA develops guidance for PAs on the safeguarding and management of documentation due to the potential of it being subsequently legally discoverable.

Concluding comments

We trust you find these comments useful in your final deliberations. Should you require any additional information, please contact APESB's Technical Director, Channa Wijesinghe at channa.wijesinghe@apesb.org.au.

Yours sincerely



The Hon. Nicola Roxon
Chairman

Appendix A

APESB's Comments

APESB's response to the questions raised by the IESBA in the ED is as follows:

General Matters

1. Where law or regulation requires the reporting of identified or suspected NOCLAR to an appropriate authority, do respondents believe the guidance in the proposals would support the implementation and application of the legal or regulatory requirement?

Where there is a legal or regulatory requirement to report, APESB agrees that IESBA's proposals will form useful guidance for PAs. For example, in Australia there is a legislative requirement for registered company auditors to report to the regulator, Australian Securities and Investments Commission (ASIC), contraventions and suspected contraventions of the *Australian Corporations Act 2001* under sections 311 *Reporting to ASIC*, 601HG *Audit of compliance plan* and 990K *Audit to report on certain matters*.

Specific legal or regulatory requirement to report NOCLAR to an appropriate authority and its application to all four frameworks

We note that IESBA's proposed framework for auditors and senior PAs in Business (PAIBs) specifically addresses circumstances in which there is a legal or regulatory requirement to report identified or suspected NOCLAR to an appropriate authority (paragraphs 225.19 & 360.17). However, in respect of other PAs in public practice and other PAIBs it is indirectly addressed as a matter to be considered (paragraphs 225.42 & 360.31).

If there is a specific legal or regulatory requirement to report to an appropriate authority in a jurisdiction (i.e. Anti-Money Laundering Legislation), we believe that this is likely to apply to all categories of PAs and that it may be prudent to reflect this obligation in a similar manner in all four frameworks.

During APESB's consultation process, Australian stakeholders have commented that IESBA's proposals should make it clear that a PA should only consider reporting to an external party or an appropriate authority if there is sufficient evidence, and that it should not be based on a suspicion of a likely NOCLAR.

2. Where there is no legal or regulatory requirement to report identified or suspected NOCLAR to an appropriate authority, do respondents believe the proposals would be helpful in guiding PAs in fulfilling their responsibility to act in the public interest in the circumstances?

Subject to APESB's recommendations (refer page 2), we believe that IESBA's proposals provide useful guidance to a PA when fulfilling their responsibility to act in the public interest.

3. The Board invites comments from preparers (including TCWG), users of financial statements (including regulators and investors) and other respondents on the practical aspects of the proposals, particularly their impact on the relationships between:

(a) Auditors and audited entities

Scope of the Auditors' NOCLAR framework

We acknowledge that auditors have a greater responsibility to take action particularly due to the nature of the auditor's remit and that they have an operating framework within the statutory audit to report NOCLAR to an appropriate authority. We understand that IESBA is distinguishing between audits of financial statements and other assurance services provided by an auditor in the application of the proposed NOCLAR framework. IESBA's rationale for adopting this approach is due to the provision of review and other assurance engagements varying significantly around the world and the perceived lower level of public reliance on these engagements.

However, APESB is not convinced of IESBA's argument to limit the auditor NOCLAR framework to audits of financial statements and to exclude reviews of financial statements. We note that this will create an internal inconsistency in the Code when compared to engagements to which Section 290 *Independence-Audit and Review Engagements* of the Code is applicable.

Accordingly, we believe that the NOCLAR framework for auditors of financial statements should apply in a similar manner to section 290 as:

- based on IESBA's research, over 100 countries have adopted the Code globally, which includes the auditor independence requirements of section 290;
- the global regulatory community uses Section 290 as the basis of auditor independence requirements which includes reviews of financial statements; and
- this will enhance the PAs in public practices' usability and understanding of the Code as both the auditor independence provisions and the proposed NOCLAR frameworks will have equal application.

Explicit guidance on the action that an external auditor is required to take, upon receipt of information on NOCLAR from other PAs or PAIBs

We note that other PAs in public practice (paragraph 225.44), and senior PAIBs (paragraph 360.18) have the ability to report to the external auditor. However, the auditors' NOCLAR framework is silent on what action the auditor should take upon receipt of this information from other PAs in public practice or a senior PAIB. Therefore, we recommend that IESBA develops explicit guidance on the obligations of the external auditor in these circumstances.

(b) Other PAs in public practice and their clients

SMPs

APESB is of the view that for SMPs who operate in the SME sector this proposed standard is likely to impact adversely on their trusted relationship with their clients, particularly if the clients perceives that the PA is likely to report instances of NOCLAR. There is also likely to be an administrative burden on SMPs as they will have to

investigate cases of potential NOCLAR and are unlikely to recover these costs from clients.

We bring this matter to IESBA's attention due to a likely commercial impact of these proposals on SMPs and their clients. We note that that a SMP will only contemplate such action in extreme situations and only where there is credible evidence of actual and potential harm to stakeholders or the wider public. We acknowledge that in the majority of the instances the identified or suspected NOCLAR is unlikely to meet this threshold test.

We believe that professional bodies and accounting educators have a significant role to play in informing and educating SMPs on the practical implementation of these proposals.

Scope exclusion for Insolvency appointments

In Australia where there is an insolvency appointment, the PA in public practice is appointed in accordance with specific legislation, and there is no contractual client relationship. As a result of not having a client relationship, these insolvency services do not come within the scope of Part B *Professional Accountants in Public Practice* of the Code.

Furthermore, it is possible that in these appointments, there are likely to be instances of NOCLAR. However, we note that the applicable Australian legislation specifies how the PA should deal with these identified cases of NOCLAR.

Due to the nature of the practitioner's relationship (i.e. acting in a fiduciary capacity as a principal), we recommend that IESBA considers the provision of insolvency services pursuant to legislation as a scope exclusion in paragraph 225.8 in the following manner:

This section does not address:

(d) appointments to provide insolvency services pursuant to legislation

Guidance on follow-up processes for PAs in public practice other than auditors in respect of NOCLAR

APESB is of the view that the reporting of NOCLAR by other PAs in public practice to the external auditors should not mean that they do not need to take any further action. Accordingly, we recommend that IESBA considers whether the PA should take further action subsequent to informing the auditor.

(c) PAIBs and their employing organizations

Additional guidance in respect of resignation

During APESB's consultation process, Australian stakeholders representing the PAIB community raised concerns in respect of the proposal for a PAIB to consider resigning from the employing organisation (paragraph 360.23) and the consequential economic impact on the PAIB in terms of loss of livelihood.

APESB recommends that IESBA clarify in paragraph 360.23 that a PAIB should only contemplate this course of action in extreme circumstances.

Guidance on follow-up processes for senior PAIBs in respect of NOCLAR

APESB is of the view that the reporting of NOCLAR by senior PAIBs to the external auditors should not mean that they do not need to take any further action. Accordingly, we recommend that IESBA considers whether the senior PAIBs should take further action subsequent to informing the auditor (refer general matter no. 3 (a)).

General comment on the development of case studies

Stakeholders who attended the APESB roundtables held in Australia suggested that IESBA should consider developing case studies and example scenarios that demonstrate how the four frameworks would apply in different circumstances. The development of case studies and examples will illustrate the application of the frameworks to different scenarios and enhance all PAs understanding of the practical implementation aspects of these proposals.

Specific Matters

4. Do respondents agree with the proposed objectives for all categories of PAs?

APESB agrees with the proposed objectives for all categories of PAs. APESB believes that these objectives clarify the PA's responsibilities and this approach is likely to assist the professional bodies and regulators who enforce the Code.

5. Do respondents agree with the scope of laws and regulations covered by the proposed Sections 225 and 360?

APESB favourably notes the change in the scope of laws and regulations covered by the revised proposals to be aligned with ISA 250 *Responding to Non-Compliance or Suspected Non-Compliance with Laws and Regulations*. However, we respectfully raise the following matters for IESBA's consideration.

Clarification that scope of laws and regulations should address matters other than financial statements

We note that the scope of the laws and regulations covered in IESBA's proposals also comprise of activities that are not associated with financial statements. Therefore, we are of the view that the scope of laws and regulations should be amended from 'financial statements' to 'financial statements or other underlying subject matter' to clearly state IESBA proposed scope that the NOCLAR framework address subject matter other than financial statements.

Accordingly, we propose the following editorials to paragraphs 225.5 and 360.5 for IESBA's consideration:

- (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 or other underlying subject matter; 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 or other underlying subject matter, 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 list of examples of laws and regulations should be segregated into two categories

APESB notes that the list of examples provided by IESBA in paragraphs 225.6 and 360.6 are useful for PAs, as it illustrates the applicable laws and regulations included in the scope of the ED. However, stakeholders have expressed concerns about the breadth of laws and regulations included in paragraphs 225.6 and 360.6 as it appears to be

inconsistent with paragraphs 225.14, 225.37, 360.15 and 360.32 which stipulates that PAs are not expected to have detailed knowledge of laws and regulations beyond their subject matter expertise.

We believe that some of the laws and regulations provided as examples may create a perception with the public and clients that a PA has expertise in these matters when they are not within the PA's expertise (e.g. environmental protection and public health and safety).

We recommend that it would be useful if IESBA categorises the laws and regulations in paragraphs 225.6 and 320.6 to distinguish between those that are likely to be within a PA's expertise and those of which a PA is likely to have only a general knowledge.

In addition, we suggest that IESBA considers including privacy and data protection legislation as another example of laws and regulations to be considered.

Clarify the treatment of a suspected NOCLAR reported to an appropriate authority

Once the above categorisation is completed, we then propose that IESBA clarifies (in paragraphs 225.27, 225.43, 360.26 and 360.34) that an identified breach of law or regulation should be in respect of a matter that is within a PA's subject matter expertise (such as Corporations Act of the relevant jurisdiction) and a suspected breach is likely to be within a PA's general knowledge (such as public health and safety).

Additionally, we believe that where a PA is considering reporting a breach within the PA's general knowledge to an appropriate authority, it should always be treated as a suspected NOCLAR, due to the following:

- NOCLARs are likely to be complex issues, and PAs may not have access to sufficient information and/or evidence to form a conclusion beyond reasonable doubt; and
- only the courts can determine whether a NOCLAR has actually occurred.

Legal privilege and engagement of other professionals

During APESB's consultation process, Australian stakeholders noted that IESBA's NOCLAR proposals may discourage entities from engaging PAs in favour of legal professionals who are not subject to these requirements in forensic and similar consulting engagements where there are likely to be instances of NOCLAR. As a lawyer's advice is protected by legal privilege, clients may prefer to engage a lawyer who in turn engages the PA rather than engaging a PA directly to perform these engagements and thus overcoming the NOCLAR provisions in the Code. We bring this matter to IESBA's attention as it is a likely commercial impact of these proposals and is of concern to Australian stakeholders.

We also believe that paragraph 225.44 should be revised to state in a stricter manner that the factors noted in that paragraph will preclude a PA from disclosing to an external party.

6. Do respondents agree with the differential approach among the four categories of PAs regarding responding to identified or suspected NOCLAR?

APESB is supportive of the differential approach as it is reflective of a PA's level of authority and influence subject to our comments below:

- the auditors' framework should be aligned with the same scope as section 290 (refer general matter no.3); and
- the same documentation requirements should apply for auditors, other PAs in public practice and senior PAIBs (refer specific matter no.9).

Consideration of a PA's psychological wellbeing and professional reputation

APESB believes that in addition to the consideration of a PA's physical safety (refer paragraphs 225.27 and 360.26), the PA may be exposed to psychological pressure from superiors and could also face severe professional reputational damage. We suggest that IESBA incorporate these considerations into the proposed framework in the following manner:

The determination of whether to make such a disclosure will also depend on external factors such as:

- *Whether there are actual or potential threats to the physical safety, psychological wellbeing and professional reputation of the professional accountant or other individuals.*

7. With respect to auditors and senior PAIBs:

- (a) Do respondents agree with the factors to consider in determining the need for, and the nature and extent of, further action, including the threshold of credible evidence of substantial harm as one of those factors?**

APESB concurs with the factors that auditors and senior PAIBs should consider when determining the need for further action such as the threshold of credible evidence of substantial harm.

- (b) Do respondents agree with the imposition of the third party test relative to the determination of the need for, and nature and extent of, further action?**

APESB agrees with the use of the reasonable third party test.

- (c) Do respondents agree with the examples of possible courses of further action? Are there other possible courses of further action respondents believe should be specified?**

We agree with the examples of possible courses of further action subject to our comments in respect of specific matter no. 3.

- (d) Do respondents support the list of factors to consider in determining whether to disclose the matter to an appropriate authority?**

We are supportive of the factors to consider when determining whether to disclose the matter to an appropriate authority.

8. For PAs in public practice providing services other than audits, do respondents agree with the proposed level of obligation with respect to communicating the matter to a network firm where the client is also an audit client of the network firm?

We are of the view that for audit clients there should not be a distinction between the firm and network firm. We note that the primary purpose of incorporating the network firm

definition in section 290 was to treat the firm and network firm in a similar manner in respect of auditor independence requirements. Accordingly, we are not supportive of there being a lesser obligation of communicating with an audit engagement partner when the client is being audited by a network firm.

Given the global use of the Code, and the treatment of network firm in a similar manner to the firm in section 290, creating this distinction of reporting NOCLAR for an audit client is not advisable.

As noted by IESBA, if there are laws governing prohibition of communication of a matter outside its jurisdiction, then the general override that the whole Code is subject to the laws and regulations of the jurisdiction will apply and it is not necessary to create this distinction due to the circumstances of one or more jurisdictions.

During our consultation process, stakeholders also raised the following issues for IESBA's consideration:

- due the varied nature of engagements carried out by the firm (i.e. sustainability reporting, renewable energy reporting etc.), the engagement team may comprise of personnel who are not PAs and their knowledge, expertise and ability to identify or act on NOCLAR may differ to a PA. In these circumstances is the PA responsible if a non-PA team member fails to identify a suspected act of NOCLAR?; and
- the sophistication, sharing of information and confidentiality agreements that exist between network firms could vary significantly between networks and this issue should be taken into consideration in developing IESBA's proposed framework.

9. Do respondents agree with the approach to documentation with respect to the four categories of PAs?

Documentation requirements for auditors, PAs in public practice and senior PAIBs

APESB is of the view that other PAs in public practice and senior PAIBs should be subject to the same documentation requirements of the proposed framework as auditors, particularly where the PA is considering reporting a significant NOCLAR to an appropriate authority.

In Australia, APESB has issued APES 320 *Quality Control for Firms* (APES 320) that incorporates ISQC 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements* (ISQC 1). APES 320 mandates that all PAs in public practice and firms establish policies and procedures in respect of quality control matters including documentation (refer paragraphs 124 and 129¹). Accordingly, the existence of APES 320 will mean that other PAs in public practice would have to document on how they have addressed their compliance with the proposed NOCLAR provisions in the Code.

We believe that in circumstances where senior PAIBs are considering reporting to an appropriate authority, they should also document those circumstances given their positions and authority within their entities. We believe that this will be an appropriate risk management strategy given the greater responsibilities these roles carry.

¹ Accounting Professional & Ethical Standards Board. APES 320 *Quality Control for Firms*: May 2009. Documentation of the system of quality control: Paragraphs 124 and 129, Page 24.

Therefore, we advocate a similar approach to documentation in respect of the three categories of PAs noted above.

We understand IESBA's reasons for encouraging documentation in respect of other PAIBs and we agree with this approach.

In respect of circumstances where a PA has reported an identified or suspected NOCLAR to an appropriate authority, we recommend that IESBA develop guidance for PAs on the safeguarding and management of documentation as it is more than likely that this documentation will be subsequently legally discoverable.

Other matters

Professional Appointment – Communication with the previous auditor

We are strongly supportive of IESBA's proposed new paragraph to establish communication between the incoming auditor and previous auditor in respect of audits of financial statements. APESB has enacted a similar provision in the current Australian Code (refer APES 110, *AUST paragraph 210.11.1*²) which address this issue.

² Accounting Professional & Ethical Standards Board. *Compiled APES 110 Code of Ethics for Professional Accountants: November 2013. Section 210 Professional Appointment: Change in a Professional Appointment: Paragraph AUST 210.11.1, Page 35.*