ASSIREVI
Associazione Italiana Revisori Contabili

Il Presidente

International Ethics Standards Board for Accountants
International Federation of Accountants
529 Fifth Avenue, 6th Floor
New York, NY 10017

22 September 2015

Exposure Draft: Responding to Non-Compliance with Laws and Regulations

Dear Sirs,

Assirevi is the association of Italian audit firms. Its member firms represent the majority of the audit firms under the oversight of CONSOB (*Commissione Nazionale per le Società e la Borsa*) and are responsible for the audit of almost all of the companies listed on the Italian stock exchange. Assirevi promotes technical research in the field of auditing and accounting and publishes technical guidelines for its members. It collaborates with Governmental bodies, CONSOB, the Italian accounting profession and other bodies in the development of auditing and accounting standards.

Assirevi is pleased to submit its comments on the Exposure Draft "*Responding to Non-Compliance with Laws and Regulations*" issued by IESBA in May 2015.

Our detailed comments are set out in the attached document.

Should you wish to discuss our comments, please do not hesitate to contact us.

Yours faithfully,

Mario Boella
Chairman of Assirevi

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COMMENTS ON THE IESBA EXPOSURE DRAFT

Responding to Non-Compliance with Laws and Regulations

(May 2015)

Assirevi would like to thank the IESBA for being given the opportunity to comment on this new Exposure Draft (hereinafter the "ED"), which is the result of the debate initiated after the previous proposal to change the *Code of Ethics* of 2012 entitled "*Responding to a Suspected Illegal Act*". In this regard, Assirevi wishes to highlight its appreciation of the changes in approach introduced by the ED compared to the previous consultation of 2012.

Assirevi subscribes to the objective underlying this consultation of strengthening the role of the independent auditor in order to further consolidate the perception that an audit is carried out for the benefit of the market and, more generally, in favour of a broad community of people and institutions that rely on the quality of the auditor's work.

In this respect, Assirevi appreciates the ED's approach to create a differentiation between the conduct required of professional accountants who perform audits and that of professional accountants in public practice providing professional services other than audits.

Nevertheless, Assirevi considers it appropriate to reaffirm the characteristics, nature and inherent limits of an audit in order to preserve the auditor's specific function, which remains focused on enhancing the reliability of financial statements.

In our view, actions that could change the auditor's role should be carefully assessed under many aspects, also because this may affect the system in terms of costs.

Accordingly, Assirevi sets out herein its observations on the ED and presents, in the following general comments, certain critical issues that we believe are worthy of additional consideration.

Moreover, given Assirevi's specific role in Italy, the ED was examined exclusively from the point of view of the professional accountant in public practice.

1) Considerations on the usefulness of the guidance in the ED in jurisdictions where laws and regulations already require the reporting of identified or suspected non-compliance to an appropriate authority (see Questions. 1 and 2 of the ED).

Assirevi supports IESBA's objective to develop a suitable framework to guide the auditor in determining how best to safeguard the public's interests when, in the course of providing professional services, he or she becomes aware of non-compliance with laws and regulations committed by the management of the audited entity or from those charged with governance (hereinafter "TCWG").

Assirevi believes, however, that provisions and principles contained in the ED should apply and be supportive for professional accountants in public practice providing audit services in jurisdictions in which there are no specific regulations on the reporting of identified or suspected non-compliance with laws and regulations. In such contexts, in effect, the content of the ED certainly could be useful for the auditor and allows, in principle, to fill any shortcoming in the legal and regulatory system to which professional accountant is subject.

Different considerations apply instead for auditors of jurisdictions where there is a local legal or regulatory framework that already requests the auditor to report identified or suspected non-compliance with laws and regulations. Indeed, the guidance proposed in the ED could generate problems of compatibility with the provisions already set by national regulations, with significant risks of uncertainty in interpretation and implementation and with the possibility of a regulations overlap that could affect the quality of the audit.

In this respect, the Italian legal system, for example, already provides for a specific legal framework on the subject matter of the ED, and which, in certain aspects, appears to be even more stringent than the ED.

It should also be considered that national jurisdictions may also have set up their own systems of corporate governance in a manner suitable to prevent the violation of laws and regulations by management and TCWG. The Italian regulatory framework, for example, has always stipulated the *Collegio Sindacale* as the body delegated under article 2403 of the Italian Civil Code (and article 149 of the Consolidated Law on Finance (TUIF) for listed companies) to supervise "*the compliance with laws and the company by-laws, the principles of proper management and the adequacy of the organizational, administrative and reporting structure and its actual operation*". The assignment to the auditor of the duties indicated in the ED would result in an overlap with that required of the board of statutory auditors by national legislation, and could, therefore, duplicate functions and create misunderstandings on the allocation of roles and responsibilities between these parties, and impact the efficiency of a system which has a long-established equilibrium.

In addition, it is worth underlining that in many countries, including Italy, the Code of Ethics and the International Standards on Auditing issued by the IAASB are adopted by law and therefore become part of the local regulatory framework. With this in mind, it would be desirable to avoid inconsistencies between simultaneously applicable rules.

Finally, it should be noted that the recent reform of the audit market introduced in Europe, with the amendment of Directive 2006/43/EC and the publication of EU Regulation 537/2014, assigned special obligations to European auditors in the event of non-compliance with laws and regulations by the audited company.

Article 7 of the above-mentioned Regulation 537/2014 states that when a statutory auditor carrying out the statutory audit of a public-interest entity suspects or has reasonable grounds to suspect that irregularities with regard to the financial statements of the audited entity may occur or have occurred, he shall inform the audited entity and invite it to investigate the matter and take appropriate measures.
This provision is combined with art. 12 of the same Regulation pursuant to which the auditor shall have a duty to report promptly to the competent authority supervising the public-interest entity or to the authority responsible for the oversight of the statutory auditor any "*material breach of the laws, regulations or administrative provisions which lay down, where appropriate, the conditions governing authorisation or which specifically govern pursuit of the activities of such public-interest entity"*.

Even those regulatory provisions, which in any case accompany those of the individual Member States, should be coordinated with the contents of the ED.

In the light of all the above, the ED is, in our view, a useful tool to guide the behavior of auditors operating in countries where there are no legal or regulatory requirements relating to the reporting

of identified or suspected non-compliance to the competent authorities towards the ethical requirements of the Code.

On the other hand, for auditors in countries that already have stringent regulatory rules regarding the reporting of non-compliance and the prevention thereof, the ED could create problems of interpretation and the overlapping of roles with other parties.

2) The principle of protection of the public interest referred to by the ED

One of the main objectives of the amendments made to the Code of Ethics with the ED is to "*enable PAs to meet their overriding responsibility to act in the public interest*". In this regard, paragraph 225.4 of the ED contains a concise clarification of the factors to consider in order to understand what constitutes "*public interest*" in the context of the communication of identified or suspected non-compliance. That paragraph indicates that "*What constitutes the public interest will depend on: a) the facts and circumstances of the non-compliance or suspected non-compliance; and b) the nature and the extent of the immediate or ongoing consequences to the client, investors, creditors, employees or the wider public*".

In the opinion of Assirevi, the definition of the protection of public interest of the professional accountant in public practice in accordance with the ED differs from that hitherto generally referred to in the legislation establishing the roles and responsibilities of the auditor.

In this regard, in the opinion of Assirevi, one of the most recent regulatory provisions clarifies the role of protecting the public interest that is attributed to the auditor. In particular, an initial passage of the premises of the above-mentioned EU Regulation 537/2014 reads as follows: "*Statutory auditors and audit firms are entrusted by law to conduct statutory audits of public-interest entities with a view to enhancing the degree of confidence of the public in the annual and consolidated financial statements of such entities. The public interest function of statutory audit means that a broad community of people and institutions rely on the quality of a statutory auditor's or an audit firm's work. Good audit quality contributes to the orderly functioning of markets by enhancing the integrity and efficiency of financial statements*".

Assirevi subscribes to the approach of EU Regulation 537/2014, above, and believes that as a consequence of the protection of public interest described above, the auditor is required to assess identified or suspected non-compliance that may have an effect on the financial statements. It is, in effect, the same principle provided by ISA 250.

In this regard, paragraph 29 of the ED's Explanatory Memorandum indicates instead that "*the proposed pronouncement goes beyond ISA 250*" and that the objective of the amendments of the Code of Ethics "*is to call for auditors and other PA's to have regard to the wider public interest implications of the matter in terms of potentially substantial harm to stakeholders, whether in financial or non-financial terms*".

Assirevi has significant concerns about this approach. Assirevi believes that asking the auditor to evaluate any non-compliance of which he has become aware, regardless of the potential effect on the financial statements, and to consider its implications even in non-financial terms could lead to a change in the auditor's role and responsibilities. Such a change would not be supported by local legislation establishing the auditor's roles and responsibilities, nor by the applicable standards on auditing.

In the opinion of Assirevi, consideration should be taken of that set out in paragraph 4 of ISA 250: "*the requirements in this ISA are designed to assist the auditor in identifying material misstatement of the financial statements due to non-compliance with laws and regulations. However the auditor is not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations*".
The above-mentioned paragraph should, in the opinion of Assirevi, be included in the ED, in order to better identify the auditor's role and to avoid creating a public expectation gap with regard to the function of the professional accountant in public practice.
In fact, the ED indicates in general terms that: "*in the course of providing a professional service to a client a professional accountant in public practice may come across non-compliance or suspected non-compliance with laws and regulations"* (cfr. 225.1) or "*becomes aware of information concerning an instance of non-compliance or suspected non-compliance"* (cfr. 225.11, 225.34).
In the absence of the clarification requested above, it would at a minimum be necessary to clarify the meaning of "*may come across*" and "*become aware"*.

3) Considerations on the definition of "non-compliance with laws and regulations*" relevant to the* Exposure Draft

As mentioned above, from the reading of the ED it clearly emerges that the auditor is required to implement the measures provided for therein in the event of any suspected or identified "*non-compliance with laws and regulations*", whether or not they affect the financial statements subject to audit.

This approach is, in the opinion of Assirevi, overly broad and appears to significantly extend the circumstances that should be subject to evaluation by the auditor, moving away from the specific reference to the accounting aspects typically delegated to the competence of the professional accountant in public practice.
Paragraphs 225.5, 225.7 and 225.8, read in conjunction with and compared to paragraphs 6, 10, 13 and 14 of ISA 250, show that the ED is not entirely in line with that provided by the international auditing standards which only refer to non-compliance with laws and regulations identified by the auditor as part of its audit procedures that have a significant effect on the determination of the amounts and disclosures in the financial statements.
Instead, the ED introduces the concept (not found in ISA 250) of non-compliance that leads to "*wider public interest implications in terms of potentially substantial harm to the wider public, including investors, creditors and employees*".
The reference to "*potentially substantial harm*" seems to be rather generic and subjective. The ED does not set out criteria that would be useful to define "*substantial harm*", but simply states in general terms in paragraph 225.21 that "*An act that causes substantial harm is one that results in serious adverse consequences to any of these parties (entity, investors, creditors, employees or the wider public) in financial or non-financial terms*".
This implies wide discretion in defining this concept and a subjective approach to each case, with the consequent absence of benchmarks to identify non-compliance by the auditors and, more generally, by the market.

Based on the above, it would seem that the approach of ISA 250, and the reference to non-compliance that could have a significant effect on the financial statements, presents lower risks of subjectivity and ambiguous interpretation.

4) The relationship with management and TCWG and the assessment of their response to the auditor's communication

Paragraphs 225.17, 225.18 and 225.22 of the ED illustrate an approach that not only, as already described above, goes beyond ISA 250 but also assigns a different role to the professional accountant in public practice.
The ED requires the auditor to evaluate the conduct and responses of management and TCWG to his communications and, only when these responses are, in his opinion, inappropriate, to inform the supervisory authority.
This is a completely new approach compared to that provided for in the EU legislative framework referred to in paragraph 1 and in ISA 250, which assigns to the public accountant in public practice a form of oversight duty over management.
Article 12 of EU Regulation 537/2014, applicable to public-interest entity's audit, provides that the auditor shall report promptly to the competent authority supervising that entity or the competent authority responsible for the oversight of the statutory auditor or audit company "*a material breach of the laws, regulations or administrative provisions which lay down, where appropriate, the conditions governing authorisation or which specifically govern pursuit of the activities of such public-interest entity*".
Article 7 of the same Regulation also states exclusively that the auditor shall inform the managements of the audited entity and invite it to investigate the matter and take appropriate measures to deal with such irregularities and to prevent any recurrence of such irregularities in the future. This provision does not require the auditor to assess the responses taken by management. It merely requires that the auditor informs the authorities where the audited entity not investigate the matter.

The above-mentioned EU Regulation, which, in the context of the recent reform in audit, represents for the European Legislator, the stricter rule as it applies to the audit of public interest entities. Nevertheless, this Regulation does not substantially assign to the auditor an oversight role of the management that, conversely, is found in the ED.
Similarly, Italian laws about the notification of censurable facts to the authorities provide solely that the auditor shall inform Consob without delay when any facts or events that have a significant effect on the financial statements are identified.
Also paragraph 28 of ISA 250 requires the auditor to inform the appropriate authority of any cases of significant non-compliance but it does not subordinate this notification in any way to the response of management or TCWG to the communication of the professional accountant.
On the other hand, paragraphs 225.17, 225.18 and 225.22 of the ED require the *professional accountant in public practice* to evaluate management's actions, going beyond what is currently required by ISA 250.
In addition, it seems inevitable that this situation would lead to conflict between management and the auditor about the entity's presumed non-compliance, given the subjectivity involved in interpreting the relevant laws and regulations.
Moreover, the significant discretion given to the auditor by the ED in assessing management's response exposes the professional accountant in public practice to possible disputes about its decisions in the case of identified or suspected non-compliance. As a consequence, the only behaviour that might prevent the formulation of objections to the auditor would seem to be the notification of the non-compliance to the competent authority.
This would lead to the risk of excessive notifications, which would affect the authority's effectiveness and increase disputes between auditors and audited entities.
Given the above, Assirevi believes that paragraphs from 225.17 to 225.26 should be revised to limit the auditor's involvement in assessing management's response to its communication.

5) The problem of identification of the appropriate authority to which the disclosure should be made

Identification of the appropriate authority to which the disclosure should be made could lead to significant interpretation issues, also in relation to the differences in national regulations.
For example, it may be difficult to identify the relevant authority for certain categories of non-compliance with laws and regulations, given the existence of various judicial and/or supervisory authorities that could potentially be interested. Therefore, specification of which authority is to be contacted should be agreed at the local level. Should national legislators not provide for this, it could create significant uncertainty about application of the disclosure obligation to the appropriate authority, proposed by the ED.
It would be appropriate that the ED clarifies that the appropriate authority to which the disclosures are to be made is should established by local regulations and laws.

6) Identification of "Clearly inconsequential matters".

The ED excludes from the application of Section 225 "*matters that are clearly inconsequential*". However, this definition of that term is not clear. The ED simply states that those *"matters"* that are "*clearly inconsequential*" are considered as such by "*their nature and their impact, financial or otherwise, on the client, its stakeholders or the wider public*".
This is a very vague definition that could lead to numerous interpretative problems.
Assirevi recommends that the IESBA provide a more precise description of these matters, which are excluded from the scope of application of Section 225.

7) Considerations on the application of the ED to professional accountants providing professional services other than audits of financial statements.

The obligation to report identified or suspected non-compliance with laws and regulations set by the ED for professional accountants providing professional services other that audits should take due account of various peculiarities and objectives that characterize non-audit services. These considerations should lead to the understanding of how professional accountants providing non-audit services, depending on the engagement given to them, may face limitations in having contact with the appropriate TCWG and in obtaining sufficient information to enable them to exercise their professional judgment on the issue of non-compliance. For this reason, they may not have all the necessary information to evaluate any circumstances underlying suspected non-compliance and they may also not have access to the appropriate level of management in order to apply the measures required by the ED. Assirevi, therefore, proposes that the IESBA modify the ED proposal, establishing a principle in which the obligations of professional accountants are differentiated based on the characteristics of the non-audit services engagement.

Moreover, the current wording of paragraph 225.43 of the ED provides that, in the event of non-compliance or suspected non-compliance, the professional accountants have to evaluate whether to disclose the matter to the statutory auditor.
At the same way, paragraph 225.40 requires that the professional accountant engaged in services other than audits that belongs to the same network as the auditors must assess whether or not to communicate the non-compliance or suspected non-compliance to the engagement partner of the audit.
Instead, in accordance with paragraph 225.39 of the ED, the professional accountant providing non-audit services for an audit client of the firm must communicate non-compliance to the engagement partner of the audit.

This approach does not seem to take adequate account of the eventual confidentiality obligations of the professional accountant in the non audit services engagement. The ED simply reports the existence of this issue in paragraph 225.44, without considering the implications or providing more specific guidelines.

In this context, in order to solve the above-mentioned critical issues, it could be preferable that the ED differentiate the behavior of the professional accountant providing non-audit services by virtue of the eventual confidentiality issues which may impede the communication to the engagement partner. In other words, in Assirevi's opinion, where confidentiality limits exist, the ED should require the professional accountant to communicate with the company's management and TCWG, asking them to start appropriate contact on the question with the statutory auditor. In cases where there is no confidentiality limits, the ED could maintain the provision regarding direct communication to the auditor of non-compliance or suspected non-compliance by the professional accountant providing non-audit services.

Finally, it should be noted that the disclosure of non-compliance or suspected non-compliance can be problematic especially if the professional accountant is involved in forensic services, which, as is well known, could be aimed toward detecting non-compliance with laws or regulations perpetrated by the management of the company which has assigned the engagement. Requesting a disclosure of the non-compliances discovered during forensic services could, in the opinion of Assirevi, jeopardize the objective and the reasons for which these engagements are assigned. Accordingly, it would be appropriate that the new Code of Ethics confers an exemption from the obligations of paragraphs 225.33 and following to forensic services.

Milan, 22 September 2015