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Exposure Draft, *Proposed Amendments to the IAASB's International Standards – Responding to Non-Compliance or Suspected Non-Compliance with Laws and Regulations*

Dear Ms. Healy:

Ernst & Young Global Limited, the central coordinating entity of the Ernst & Young organization, welcomes the opportunity to offer its views on the Exposure Draft, *Proposed Amendments to the IAASB's International Standards – Responding to Non-Compliance or Suspected Non-Compliance with Laws and Regulations* (ED), issued by the International Auditing and Assurance Standards Board (IAASB).

As a member of the Forum of Firms, we have global policies and methodologies that conform to the International Ethics Standards Board for Accountant's Code of Ethics for Professional Accountants (IESBA Code) and the International Standards on Auditing (ISAs). Therefore, it is very important that the two sets of standards can be effectively executed in tandem on our audits.

We find it very helpful for the ISAs to highlight where the auditor may have additional ethical responsibilities for circumstances or events that may arise during the audit, including making references to the applicable sections of the IESBA Code, where applicable. In regard to responding to non-compliance or suspected non-compliance with laws and regulations (NOCLAR), this is clearly a topic that has significant cross-over between the IESBA Code and the ISAs, given that both sets of standards have dedicated requirements addressing NOCLAR. We are therefore supportive of the proactive approach the IAASB has taken to analyze the compatibility of its International Standards with, including appropriate linkages to, the proposed revisions to the IESBA Code dealing with responding to NOCLAR.

We believe that the proposed limited amendments are appropriate in their nature and extent, and that the IAASB has appropriately considered updates not only to ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, but across the suite of International Standards, where necessary. Our comments are focused on the clarity and consistency of the limited amendments, including the degree of alignment with the IESBA NOCLAR proposals. We also have identified a few areas of ISA 250 that we believe may benefit from clarifying application material in light of the IESBA NOCLAR proposals.

Responses to the specific questions and general matters on which the IAASB is seeking feedback are set out in Sections 1 and 2, respectively. Our letter also includes a number of editorial observations and suggestions, which are set out in Appendices A and B to this letter.

1. Responses to specific matters on which the IAASB is seeking comments

1.1 *Whether respondents believe the proposed limited amendments are sufficient to resolve actual or perceived inconsistencies of approach or to clarify and emphasize key aspects of the NOCLAR proposals in the IAASB's International Standards.*

We agree with the IAASB's approach of proposing limited amendments to the International Standards consisting of clarifications to requirements or application material to address circumstances when the auditor is also required to comply with the IESBA NOCLAR proposals. However, we have concerns about the clarity of certain proposed amendments, including the degree of alignment with the IESBA NOCLAR proposals. We also have identified a few areas of ISA 250, in particular, that we believe may benefit from clarifying application material in light of the IESBA NOCLAR proposals, as well as a few areas in which we see inconsistency in the wording of the amendments.

Clarity of amendments to reflect proposed IESBA Code changes to the auditor's duty of confidentiality

We believe the most significant and important proposed amendments to the International Standards included in the ED deal with the introduction of provisions in the IESBA Code that allow for the duty of confidentiality to be overridden when the auditor makes the determination that disclosure of NOCLAR to an appropriate authority is the appropriate course of action in the circumstances. We agree with the paragraphs of the Standards to which the IAASB has proposed clarifications to highlight this aspect of the IESBA NOCLAR proposals, but we do have some concerns about the clarity of the amendments.

Specifically, the amendments include the introduction of the term "right" (as in "ethical right") to concisely describe the auditor's ability to report NOCLAR to an appropriate authority without breaching confidentiality. Although we agree conceptually that this may be a new "right" of the auditor, we do not believe that the term "right" effectively captures the underlying decision-making process and evaluation that would occur before exercising this right, which is a large focus of the IESBA NOCLAR proposals. In addition, the IESBA does not refer within its proposals to the auditor having a "right" to report, and therefore we believe there is a risk of confusion.

We would prefer that the IAASB use terminology that is more closely aligned and representative of the IESBA NOCLAR proposals, recognizing that the ISAs must also remain operable with ethical requirements other than the IESBA Code. This preference extends beyond eliminating the use of the term "right" to the language used in the fuller descriptions of the IESBA NOCLAR proposals in the application material.

In Appendix A to our letter, we have provided for the IAASB's consideration editorial suggestions to ISA 250.28 and ISA 250.A19, as well as conforming language to other paragraphs in the International Standards where this particular aspect of the IESBA NOCLAR proposals is highlighted or described.

Other areas within ISA 250 that may benefit from additional clarity or guidance about the NOCLAR proposals

- **ISA 250.8a:** We agree with the addition of this proposed paragraph to highlight the fact that additional responsibilities for NOCLAR may exist under relevant ethical requirements. We believe that it would be beneficial to include application material to this new paragraph with a brief explanation of the nature of those additional responsibilities under the IESBA Code (as an example). In particular, it would be helpful to highlight that the IESBA Code requires evaluation of identified or

suspected instances of NOCLAR using more extensive criteria than materiality to the financial statements and the effect on the audit, which may result in the auditor taking further or different actions to respond to NOCLAR under the IESBA Code than what may be required under the ISAs.

- **ISA 250.19:** This paragraph (which has remained unchanged from extant) requires that the auditor consider obtaining legal advice related to suspected NOCLAR only if the effect of such NOCLAR may be material to the financial statements. Section 225.14 of the IESBA Code suggests that legal advice may be necessary as part of understanding whether an act constitutes non-compliance. Further, the evaluation of NOCLAR under the IESBA Code is not restricted to consideration of materiality to the financial statements. We believe it would be useful to clarify in the guidance to ISA 250.19 that it also may be necessary for the auditor to consider legal advice when there may be other implications for the audit (such as those highlighted in paragraph 21) or when further actions may be required under relevant ethical requirements.
- **ISA 250.A12a and ISA 250.A17:** We find the new guidance in these paragraphs to be somewhat overlapping and unclear. It may be clearer to have a single paragraph that applies equally to paragraphs 18-21 that explains that compliance with relevant ethical requirements may result in either or both:
 - The identification of NOCLAR or suspected NOCLAR beyond that identified in the required procedures in paragraphs 12-16 of ISA 250.
 - Further information about instances of identified or suspected NOCLAR that is relevant to the auditor's responsibilities under paragraphs 18-21.
- **ISA 250.A18:** This paragraph (which has remained unchanged from extant) deals with the auditor's consideration of whether to withdraw from the engagement when management or those charged with governance do not take appropriate remedial action for NOCLAR. Section 225.30 of the IESBA Code states that withdrawing from the engagement would not be a substitute for taking other actions that may be needed to achieve the objectives of this section of the Code. It may be useful to indicate in paragraph A18 that legal advice may also be needed to determine whether further actions may be required (regardless of the intent to withdraw) as a result of legal duties or ethical responsibilities, including in regard to reporting NOCLAR to parties outside the entity.
- **Relationship of NOCLAR to Key Audit Matters communicated in accordance with ISA 701.** In light of the IAASB's recent release of ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, we believe that it would be beneficial for the IAASB to clarify whether the identification of NOCLAR or suspected NOCLAR and the possible resulting actions by the auditor under the IESBA NOCLAR proposals affect the auditor's determination of key audit matters in any manner. We note that ISA 250 has a section with the heading "Reporting Non-Compliance in the Auditor's Report on the Financial Statements", which may be the appropriate place to provide additional guidance.

For example, if the auditor is prohibited from alerting ("tipping off") the entity about instances of identified or suspected NOCLAR, then these matters are not included in the population of matters communicated with those charged with governance and therefore could not be determined to be key audit matters.

In circumstances in which instances of identified or suspected NOCLAR are discussed with those charged with governance (and the auditor concludes that the matters do not give rise to a modified

opinion), the matters discussed are by definition included in the population of matters from which key audit matters are determined in accordance with ISA 701. As with any other matter communicated with those charged with governance, the relative significance of the NOCLAR matter for the current period audit would be considered. Should the auditor determine that a matter related to NOCLAR is a key audit matter, the auditor would communicate that key audit matter in the auditor's report unless the matter meets the criteria for excluding communication in paragraph 14 of ISA 701.

Other comments

- **ISA 250.A5a:** We do not believe that proposed paragraph A5a, which presents high-level categories of laws and regulations, is helpful because it does not (and we understand that it cannot) distinguish between laws and regulations that have a direct effect on the audit and those that do not. We believe that the existing examples included within paragraph 6 are more helpful because they are presented in context of the definitions.
- **New guidance regarding “tipping-off” prohibitions on communication with the entity.** We agree with the addition of guidance to highlight that laws or regulations may prohibit alerting (“tipping-off”) the entity regarding identified or suspected NOCLAR. We have two observations in regard to the consistency with which this guidance has been included in the ISAs:
 - In ISA 260.7, this guidance is placed in the context of an action that prejudices an investigation by an appropriate authority. However, this context is not used in the new guidance in ISA 250.A15 and ISA 240.A59A.
 - The requirement in ISA 250.22 would appear to be subject to the same restriction regarding “tipping-off”, but the new guidance is not included here.
- **Other editorial observations and suggestions.** Please refer to Appendix B to our letter for other editorial observations and suggestions, several of which are related to use of consistent language across the ISAs. We also specifically suggest that the IAASB consider amending the definition of “non-compliance” in ISA 250 to explicitly state that non-compliance includes personal misconduct related to the business activities of the entity by those charged with governance, management or employees of the entity.

1.2 The impact, if any, of the proposed limited amendments in jurisdictions that have not adopted, or do not plan to adopt, the IESBA Code. For example, would any of the changes to the IAASB’s International Standards be deemed incompatible with the relevant ethical requirement that would apply in those jurisdictions?

We do not believe that the changes to the IAASB’s International Standards would be deemed incompatible with the relevant ethical requirements in jurisdictions that have not adopted, or do not plan to adopt, the IESBA Code, but such impact is better assessed by the jurisdictions affected.

Response to general matters on which the IAASB is seeking comments

2.1 Effective Date—It is anticipated that the effective date of the amendments to the IAASB's International Standards would be aligned with the effective date of the NOCLAR standards, which the IESBA will determine in due course.

We are supportive of the alignment of the effective date of the proposed revisions in the ED with the effective date of the NOCLAR standards, as determined by IESBA.

Response to invitation for additional input

2.2 Do respondents have a view whether a more fulsome review of ISA 250 would be beneficial in due course? Respondents are asked for their comments, if any, on what further changes may be required to ISA 250 and why.

Although there could be organizational improvements and further useful clarifications to ISA 250, we do not believe a more fulsome review of ISA 250 is necessary in the short term as we believe the standard is “fit for purpose” in the current environment. We have not experienced implementation issues that cause us to believe that the standard is in need of fundamental revision.

However, there likely are opportunities in certain ISAs to better highlight or clarify the auditor's responsibilities related to NOCLAR, such as in the context of group audits or use of experts. We believe that the IAASB could consider such improvements as part of its in-process projects related to group audits, quality control and audits of financial institutions.

We would be pleased to discuss our comments with members of the IAASB or its staff. If you wish to do so, please contact Karen M. Golz, Global Vice Chair, Global Professional Practice (karen.golz@eyg.ey.com).

Yours sincerely,

Ernst + Young Global Limited

Appendix A: Editorial suggestions for ISA 250.28 and A19, and conforming amendments to other paragraphs

We have the following editorial suggestions to ISA 250.28 and A19 to address our concerns expressed in Section 1.1 of our letter related to the clarity of amendments to reflect proposed IESBA Code changes to the auditor's duty of confidentiality.

28. If the auditor has identified or suspects non-compliance with laws ~~and or~~ regulations, the auditor shall determine whether the auditor has a legal ~~or ethical~~ duty to report, or ~~right ethical responsibility to determine whether~~ to report, the identified or suspected non-compliance to parties outside the entity.
- A19. If the auditor has identified or suspects non-compliance with laws or regulations, the auditor may consider obtaining legal advice to determine whether the auditor has a legal ~~or ethical~~ duty ~~or right~~ to report, ~~to parties outside the entity and, when applicable, the appropriate course of action~~ light of such duty or right or an ethical responsibility to determine whether to report, the matter to parties outside the entity. For example:
- The duty of confidentiality ~~may not apply or~~ may be overridden by laws or regulations. In some jurisdictions, the auditor of a financial institution has a statutory duty to report the occurrence, or suspected occurrence, of non-compliance with laws and regulations to supervisory authorities. Also, in some jurisdictions, the auditor has a duty to report misstatements to authorities in those cases where management and, where applicable, those charged with governance fail to take corrective action.
 - The duty of confidentiality may be overridden by provisions within the ethical requirements relevant to the audit that address responding to non-compliance with laws and regulations. Under relevant ethical requirements, the auditor may have the right an ethical responsibility to determine whether to report ~~disclose~~ identified or suspected non-compliance with laws or regulations to an appropriate authority without breaching the duty of confidentiality notwithstanding that there is no legal or regulatory requirement to do so. Further, under such relevant ethical requirements, it is not considered a breach of the duty of confidentiality if the auditor determines that such reporting is an appropriate course of action in the circumstances.¹
 - Laws or regulations or the auditor's legal or the ethical duties requirements to maintain confidentiality relevant to the audit may preclude the auditor from reporting identified or suspected non-compliance with laws and regulations to a party outside the entity.

The above suggestions are based on our views as follows:

- The phrase “ethical right” has been replaced with “ethical responsibility to determine whether to report” to provide a clearer explanation of the obligation imposed by the IESBA Code.

¹ See, for example, Section 225.24 - 225.29 of the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* (IESBA Code).

- The duty of confidentiality always applies to an audit; however, it may be overridden in certain circumstances by either laws or regulations, or explicit provisions within the relevant ethical requirements.
- The example in the second bullet should more closely align to the wording in the IESBA Code, as it is intended to represent the requirements under the IESBA Code. We have suggested alignments based on Section 225.24 and 225.29.
- Use of the phrase “ethical requirements relevant to the audit” is suggested for consistency with other ISAs. “Relevant ethical requirements” would also be a suitable alternative.

Based on the revised wording for ISA 250.28 and A19, and accompanying rationale presented above, we have the following editorial suggestions for other paragraphs included in the ED:

ISQC/ISA/ISRE reference	Observation/suggestion
ISQC 1.A56	“Relevant ethical requirements establish an obligation for the firm’s personnel to observe at all times the confidentiality of information contained in engagement documentation, unless specific client authority has been given to disclose information, or <u>the firm’s personnel have determined</u> there is a legal <u>duty</u> or ethical <u>duty or right responsibility</u> to do so. In certain circumstances, the firm’s personnel may have the legal <u>duty to disclose</u> , or ethical <u>right responsibility to determine whether to disclose</u> , identified or suspected non-compliance with laws or regulations to an appropriate authority <u>and such disclosure without is not considered a breaching of</u> the duty of confidentiality...”
ISA 240.43	As written, the paragraph implies that the duty of confidentiality may include a duty or right to report to an appropriate authority, whereas it is the laws or regulations or relevant ethical requirements that may impose these duties or responsibilities. We suggest this paragraph be aligned to the wording in ISA 250.28, including our editorial suggestion to ISA 250.28 above, as follows: “If the auditor has identified or suspects a fraud, the auditor shall determine whether <u>the auditor has a legal duty to report, or ethical there is a responsibility to determine whether to report</u> , the occurrence or suspicion to a party outside the entity.” We would suggest deleting the second sentence of ISA 240.43, and including this guidance in ISA 240.A65 (see further comments on ISA 240.A65 below).
ISA 240.A65	We suggest that this paragraph be structured consistent with ISA 250.A19 (as we have revised above), other than making reference to fraud instead of non-compliance with laws or regulations. Further, we note that ISA 250.A19 provides guidance in context of the consideration of obtaining legal advice to make the determination of the auditor’s duties and responsibilities, whereas ISA 240.A65 does not.
ISRE 2400.52	We suggest wording for (d) as follows: “Determine whether <u>there is a the auditor has a legal duty to report, or ethical responsibility to determine whether to report</u> , the occurrence or suspicion of fraud or illegal acts to a party outside the entity.”
ISRE 2400.A92	We suggest aligning this paragraph to the revisions suggested for ISA 250.A19 and, as mentioned above, ISA 240.A65. We note that, similar to ISA 240.A65, this guidance is not in context of the consideration of obtaining legal advice.
ISAE 3402.A53	“...Communicating with third parties (for example, a regulator) when the auditor has a <u>legal</u> duty, or <u>ethical responsibility to determine whether, right to do so.</u> ”

Appendix B: Other editorial observations and suggestions

ISQC/ISA Reference	Observation/suggestion
ISA 220.A8a	We suggest adding a footnote to “relevant ethical requirements” as follows: <u>“See, for example, Section 210.13 of the IESBA Code”</u> .
ISA 240.3	We suggest adding the following sentence to this paragraph to align with ISA 250.5: <u>“Whether fraud has actually occurred is ultimately a matter for legal determination by an appropriate legal or adjudicative body.”</u>
ISA 240.40	We suggest inserting “unless prohibited by law or regulation” as follows: “...the auditor shall communicate these matters, <u>unless prohibited by law or regulation</u> , on a timely basis....”
ISA 250.11	We suggest explicitly stating that non-compliance includes personal misconduct related to the business activities of the entity as follows: “..Non-compliance <u>includes personal misconduct that is related to the business activities of the entity by those charged with governance, management or employees of the entity, but does not include personal misconduct by those persons that is</u> (unrelated to the business activities of the entity) <u>by those charged with governance, management or employees of the entity.</u> ”
ISA 250.19	We suggest inserting “unless prohibited by law or regulation” as follows: “...the auditor shall discuss the matter, <u>unless prohibited by law or regulation</u> , with management....”
ISA 250.22	We suggest adding a similar caveat as follows: “, other than when the matters are clearly inconsequential <u>or such communication is prohibited by law or regulation</u> ”.
ISA 250.A13	We suggest inserting an “are” to supplement “may be” in the lead-in sentence because the first bullet is indisputably an indication of NOCLAR: “The following matters <u>are or</u> may be an indication of...”
ISA 250.A18a	We suggest replacing “intended” with “possible” in the first bullet, as “intended” implies that the auditor makes a judgment about whether management may be involved in NOCLAR in the future, where we believe the auditor’s judgment is related to whether management was involved or possibly involved in NOCLAR that has occurred: “The auditor suspects or has evidence of the involvement or intended <u>possible</u> involvement of management....”