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Mr. Ken Siong
Technical Director
International Ethics Standards Board
for Accountants
529 Fifth Avenue, 6th Floor
New York
NY 10017, USA

submitted electronically through the IESBA website

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

Dear Mr. Siong,

The IDW appreciates the opportunity to comment on the above mentioned Exposure Draft and proposed changes to the Code of Ethics for Professional Accountants hereinafter referred to as “the ED” and “the Code”, respectively.

As our members are primarily engaged in public practice we have chosen to restrict our comments to those aspects of the proposals impacting auditors and professional accountants (PAs) in public practice providing services other than audits.

However, we do not believe IESBA is justified in seeking to extend this particular aspect of its proposals to all PAs, as not all PAs fulfil a public interest role to the same extent as a statutory auditor. Extending almost equally stringent requirements to all PAs could further disadvantage many members of the profession in many jurisdictions in which potential competitors are not subject to the IESBA Code.

In our comment letter dated December 12, 2012, we expressed a number of serious concerns in regard to the first exposure draft issued by the IESBA on this topic in 2012 (ED: Responding to an Illegal Act). In order to avoid undue repetition, we have chosen not to repeat these concerns in detail, and instead

include specific reference to that letter in regard to matters that remain unaddressed in the current ED.

We recognize that in many respects the current ED is a significant improvement over this first ED. In particular, the IDW is especially pleased to note both the improved alignments to ISA 250 and the withdrawal of the original proposal for the Code to require auditors to disclose identified or suspected NOCLAR to an appropriate authority. In this letter, we address our key concerns remaining in these areas.

As stated in our previous letter, we agree that it is in the public interest for there to be robust mechanisms to effectively address serious instances of NOCLAR perpetrated by entities and individuals in relation to accounting that affect the financial statements they publicize or could otherwise have a serious public interest connotation. The profession should also play a role in this regard.

However, as we explain in detail under the three sections of this letter, we still have serious concerns in regard to particular key aspects of the current ED, which we believe could make specific aspects of the proposed changes unworkable in practice. In the Appendix attached to this letter we respond to the individual questions posed in the Explanatory Memorandum.

Breaking Client Confidentiality – Disclosure to an External Authority

We note that the IESBA has withdrawn its original proposals to require an auditor to report certain matters to an external authority. As we explain below, we are concerned that the revised proposals retain a de-facto requirement for the auditor to disclose in certain circumstances. However, we remain firmly of the opinion that the legislator in a particular jurisdiction – and not the IESBA – should address the specific situations where a PA or an auditor may break client confidentiality. In this context we refer to the detailed reasoning in our letter dated December 12, 2012.

As we explain below, we do not support the proposals in paragraphs 225.24 and 225.27 whereby under the IESBA Code an auditor might disclose a matter to an appropriate authority when there is no legal or regulatory requirement to do so. We believe that the IESBA Code should mirror the extant ISA 250 and therefore not foresee auditors breaking client confidentiality unless this is specifically provided for within the applicable laws and regulations of their particular jurisdiction. We have similar concerns as to proposed paragraphs 225.39, 225.40 and 225.43, with regard to PAs providing non-audit services.

As we had pointed out in our previous letter, German law treats any such (unlawful) breach of client confidentiality as a criminal act, which carries a penalty of imprisonment for up to three years. We refer to our previous letter for further details in this context. Beyond this, there may be other legal considerations such as law of tort and contractual provisions that would be relevant in this case, which the IESBA does not appear to have considered. These factors need also to be appropriately reflected in any proposed changes to the Code, should the IESBA retain this aspect of its proposals.

Withdrawal of the requirement previously proposed

We appreciate IESBA's statement in paragraph 60 of the Explanatory Memorandum: "The Board believes that it is not appropriate to carry forward the original ED proposal for the Code to require auditors to disclose identified or suspected NOCLAR to an appropriate authority in the relevant circumstances... In the Board's view, only lawmakers in the particular jurisdiction should determine what they would intend or accept as consequences for a reporting requirement". However, we disagree with the IESBA that the proposals included in the revised ED mean that these concerns can now be dispelled.

We note with interest that throughout the Explanatory Memorandum, the IESBA, in deflecting many of the criticisms of specific aspects of the first ED, consistently points out that breaking client confidentiality is not a requirement.

Contrary to the view put forward by the IESBA in the Explanatory Memorandum, we believe that the current ED proposals do constitute a de facto requirement for an auditor to break professional secrecy and to disclose an instance of NOCLAR to an appropriate authority in certain, albeit rare, circumstances.

Firstly, the determination of whether further action is needed (paragraph 225.20) will be "dictated" by the specific circumstances encountered (paragraphs 225.21-23). The interaction of paragraphs 225.24 et seq. and paragraph 225.27 in this proposal introduce various additional factors for the auditor to consider in determining the nature and extent of further action(s). Therefore, in many cases, the determination will be extremely complex and difficult to "get right" in practice. There may be other cases where the factors "speak out" so clearly as to essentially force the determination. This determination is then "cemented" by the "test" of whether a reasonable and informed third party would be likely to conclude that the PA has acted appropriately in the public interest (paragraph 225.25).

Secondly, this determination would also have to be made in the knowledge that an inappropriate determination exposes the auditor to potential litigation from

both sides. On the one hand, if it is believed that the auditor should in the circumstances have made disclosure of NOCLAR to an external authority and failed to do so the auditor may face claimants who suffered losses as a result of the NOCLAR. If on the other hand, it is believed that the auditor should not, in the circumstances, have made disclosure of NOCLAR to an external authority, the alleged perpetrators of the NOCLAR might seek to claim for compensation against the auditor resulting from reputational harm or other adverse consequences. This effectively means that the auditors are de facto not free to decide whether or not to disclose the NOCLAR.

Uncertainty ensuing from the proposals and unintended consequences

Irrespective of whether a PA's or an auditor's decision to disclose is free or not, even a small amount of uncertainty as to

a) whether or not the ED introduces a de facto requirement for auditors to break client confidentiality,

b) in what (further) audit circumstances would client confidentiality be broken exactly, and in relation to what matters precisely, and

c) as to the potential application of this option by auditors or PAs in public practice when they provide non-audit services where there is no legal or regulatory requirement to do so

is highly problematical for the various reasons discussed below. Firm criteria are needed as well as an appropriate legal environment; neither of which are reflected in the current proposals.

For example, without a legal system in place that covers diverse related areas such as liability, whistleblower protection, anti-tipping off etc. and that provides a clear understanding of NOCLAR to be reported outside of an entity, there is a distinct lack of legal certainty for auditors, other PAs, entities engaging their services, regulators and professional bodies to whom PAs may turn for advice and for the public at large. The inclusion in paragraph 225.21 of "the legal and regulatory framework" as a factor is unsuitable as a criterion without further explanation. This general uncertainty could prove detrimental to the trust placed in all PAs and the accountancy profession as a whole.

Indeed, client confidentiality has long been a cornerstone for the auditing profession, and it is protected by law in many jurisdictions, including Germany. Legislators have generally introduced client confidentiality for various reasons, one of which is to ensure the auditor is granted access to all information and the professional accountant is in a position to provide the particular service without

limitations. We suggest there is a parallel to legal privilege designed to enable effective legal counsel, which would be impossible if information were withheld by clients. Without a secure relationship of trust with their auditors, audit clients may ultimately exercise a degree of caution in providing information to their auditors, which will be detrimental to audit quality. Thus, we believe that the legal advice obtained by IESBA (see paragraph 60 of the Explanatory Memorandum) holds equally true in relation to the current proposals.

Clients seeking non-audit services from PAs may be similarly uncertain as to if and when a PA might break confidentiality and could ultimately avoid seeking the services of a PA who is subject to the Code.

Alignment to ISA 250

As noted above, we support the improved alignment to ISA 250, but still have the following concerns in this regard:

In responding to q. 3 in the Appendix to this letter we point out a discrepancy we believe the IESBA ought to address in finalising its revisions to the Code. Without this change, the Code unnecessarily extends the auditor's work effort, and documentation requirements beyond as is already required by ISA 250, potentially resulting in additional costs to the audit and, in some cases, potential delay to audit completion.

We agree that it is appropriate for auditors to be governed by ISA 250 as to the description of laws and regulations applicable for the purposes of the Code. In responding to q. 5, we note that the proposed extension – beyond the impact on the financial statements required by ISA 250 – to include wider public interest implications in paragraph 225.7 is problematical in regard to NOCLAR to be disclosed to an external authority. However, subject to the comments we had made on page 8 of our previous letter regarding the limitations to the potential for PAs to detect illegal acts, to the extent that the auditor or PA providing non-audit services would discuss such matters with the entity's officers we believe this approach is reasonable. As stated in paragraph 225.9, it is the responsibility of the client's management, with oversight of those charged with governance, to ensure that the client's business activities are conducted in accordance with laws and regulations. We agree with IESBA that it is in the public interest for PAs to assist them in so doing.

We also refer to our response to q. 9 regarding the need to provide auditors with clarity as to the "total" documentation requirements in the event that they encounter an instance of NOCLAR.

We therefore believe that further liaison is needed between the IESBA and the IAASB in respect of these issues.

Further Issues not Addressed by Questions in the Explanatory Memorandum

Compatibility with the ISAs and the auditor's compliance with ISA 200.14

The proposals in the ED, if adopted, would increase the stringency of the extant Code in regard to instances of NOCLAR of which a PA may become aware.

We note that the IESBA has not (yet) chosen to discuss the general issue of how national ethical regimes might be measured against the IESBA Code in terms of their respective restrictiveness going forward, but believe that this is an issue that will need to be considered in conjunction with the IAASB.

An auditor is required by ISA 200.14 to: "comply with the relevant ethical requirements…". ISA 200.A14 explains: "relevant ethical requirements ordinarily comprise Parts A and B of the IESBA Code of Ethics for Professional Accountants…, together with national requirements that are more restrictive". As the Code becomes increasingly stringent – and thus will sometimes exceed national law in isolated respects, this issue will need to be addressed. In some jurisdictions there may be little or no law or regulation to address the role of a PA or an auditor encountering any form of NOCLAR. In many of the more developed jurisdictions there will be laws and regulations dealing with distinct issues e.g., money laundering and corruption etc. Legislation in the EU contains further requirements for auditors of public interest entities. As the ED potentially extends the scope to certain instances of NOCLAR including and beyond these issues, we suggest there is a need for the IESBA and the IAASB to explore how national requirements can be assessed. For example, when would they be deemed as either less, equally, or not as, restrictive as the IESBA Code in the context of this project – or should they be assessed as a whole rather than in relation to isolated aspects of the Code? In particular, the two Boards will need to consider the consequences for auditors and the compliance with the ISAs in the event that national requirements are deemed less restrictive than the IESBA Code. Of course, this issue is not limited to the proposals on NOCLAR, and we accept that this may need to be addressed "as a whole" rather in respect of isolated projects.

Notwithstanding the fact that we do not support the IESBA pursuing its proposals in regard to breaking client confidentiality, we trust that our comments

will be useful in finalizing the revisions to the IESBA Code and aligning them appropriately to the ISAs promulgated by the IAASB.

If you have any questions relating to our comments in this letter, we should be pleased to discuss matters further with you.

Yours truly,

Klaus-Peter Feld
Executive Director

Helmut Klaas
Director European Affairs

Appendix

Request for Specific Comments

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?*

No.

The IESBA is not tasked with providing guidance to supplement (a variety of differing national) laws or regulations at an international level.

Besides making the Code questionable in terms of its likely effectiveness as guidance to supplement specific national laws, certain aspects of the proposals (see below) remain potentially detrimental to the profession and to audit quality, and as such are not in the public interest.

Certainly, we do not see any need for the IESBA Code to provide implementation or application assistance for the profession in Germany.

In Germany it is a criminal offence for auditors to break client confidentiality, other than as explicitly provided in law. Similar provisions may exist in other jurisdictions.

The Code needs to be very clear on this point, so as to preclude misunderstanding in this highly sensitive aspect. Whilst the last sentence of paragraph 225.29 the Code does state “Disclosure would be precluded if it would be contrary to law or regulation”, this information may be easily overlooked when other paragraphs are read in isolation. Paragraphs 225.10, 225.19 and 225.33 serve to draw PAs’ attention to any existing obligations under national laws and regulations that require NOCLAR be reported to an external authority. As a minimum, it would be equally appropriate to add a further subsection (c) to paragraph 225.19 to draw attention to the fact that national laws may contain client confidentiality provisions that expressly prohibit further disclosure, including disclosure under the revised IESBA Code and to acknowledge such possible preclusions in paragraph 225.24.

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?*

No.

As explained in our accompanying letter we have serious concerns as to the Code seeking to "allow" (or, as we contend, including a de facto requirement in certain circumstances) breaches of client confidentiality in the manner proposed and retain our belief that IESBA is not the appropriate party to either require or "allow" a breach of client confidentiality beyond existing provisions within national laws and regulations.

The IESBA proposals in regard to a) the matters an auditor would (under the Code) potentially disclose to an external authority and b) the circumstances surrounding a determination to do so are (necessarily – given the nature of an international Code) overly vague. This lack of precision creates considerable uncertainty as explained in the accompanying letter.

Should IESBA, however, retain this aspect of its proposals, we believe that when there is no legal or regulatory requirement to report identified or suspected NOCLAR to an appropriate authority the Code needs to allow the auditor to weigh up the public interest implications of disclosure on the one hand against a breach in client confidentiality on the other in determining which should prevail in the individual audit engagement circumstances. This should involve consideration of aspects such as legal risks associated with the auditor potentially making a false accusation, and breaking client confidentiality without the client's knowledge or in the absence of the client's explicit permission.

In paragraph 225.14 IESBA rightly recognizes that "Whether an act constitute actual non-compliance is ultimately a matter for determination by an appropriate legal or adjudicative body." On this basis it would be appropriate for the determination required of the auditor to include a consideration of the likelihood of prosecution as a factor in determination of further action.

In addition, we note that the proposals do not give due regard to factors such as the contractual obligations to uphold client confidentiality. These ought to be addressed, as without this a PA complying with this aspect of the Code might be in breach of contract.

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;*

We note that the IESBA received legal advice on certain aspects of its original proposals. We believe that the potential unintended consequences described in para. 60 (i.e., detrimental impact on free flow of information between clients and PAs damaging audit quality in particular and discouraging senior PAs from remaining in the profession), and possible other consequences, are also relevant in respect of the ED.

As explained in our accompanying letter, in contrast to the IESBA's intention outlined in the Explanatory Memorandum, we believe that the proposals potentially create a de facto requirement for auditors to breach client confidentiality in some circumstances and that this, together with the lack of clarity as to what and when auditors would report externally, would create considerable uncertainty. It is this uncertainty that we believe will trigger unintended consequences, including those highlighted in the legal advice referred to in the Explanatory Memorandum, which could ultimately be detrimental to audit quality.

Proposed Extension of Audit Procedures

We have the following remarks as to the proposals that would require the auditor extend his or her procedures beyond the relevant requirements of ISA 250:

When the auditor becomes aware of information concerning an instance of non-compliance, ISA 250.18 requires the auditor to obtain an understanding of the nature of the act and the circumstances in which it has occurred. Related application guidance in ISA 250.A13 provides examples of the types of information that may be relevant in this context, indicating that the auditor's understanding would be expected to be of a relatively general nature at this initial stage. Following on from this, ISA 250.19 puts the onus firmly on the entity's management and where appropriate those charged with governance to investigate suspected instances of non-compliance and provide to the auditor sufficient information to dispel such suspicion.

In contrast, paragraph 225.11 of the Code proposes the auditor be required to obtain a more comprehensive understanding of the matter – extending the term "matter" to include both acts that have occurred as well as those that may yet occur, and extending the understanding to specifically include the application of the relevant laws and regulations to the circumstances. Thus, before any discussion with the entity's officers the proposed changes to the Code exceed extant ISA 250 and would specifically require the auditor "probe into" the matter more thoroughly than is required under ISAs.

We believe this proposed "difference" between ISA 250 and the Code is inappropriate on two counts. Firstly, in practice the auditor's required "understanding" under the Code would lead auditors to "firm up on" facts as a prerequisite to obtaining an understanding of the legal position, as – in contrast to ISA 250 – it appears that the Code is dealing with relatively well founded suspicions at this stage. Indeed, obtaining an understanding of the legal position pertaining to the individual matter (which is not required under ISA 250 at this stage) will often involve recourse to legal advice (also regulators would expect diligent documentation), which would certainly add costs to audits. Secondly, in placing the onus on the auditor at this initial stage instead of on management potentially may also lay the auditor open to claims, should the auditors "probing" be perceived as a false accusation, deformation of character or similar or in the worst case, lead to e.g., a formal investigation that may subsequently dispel the original suspicion. In addition, a perception of excessive probing by the auditor prior to a discussion of the matter with the entity's officers beyond "normal" audit procedures could be detrimental to the auditor's relationship with the client.

In our letter dated December 12, 2012, we had previously commented that IESBA's proposed approach also differed from the IAASB's approach in terms of the risk-based approach under ISAs. Whilst we recognise that paragraph 225.8(a) now clarifies the exclusion of clearly inconsequential matters, the proposals still do not recognise a risk based approach in terms of the required work effort. We refer to our previous letter in the context of this issue.

We do not believe there is justification for a different approach in any of these areas, and suggest the IESBA align the required work effort more closely to ISA 250.

We agree that it would be in the public interest for the auditor to prompt the entity's officers to take appropriate action as proposed in paragraphs 225.17 and 225.18. However, beyond this and as explained above, we do not support the Code introducing a de facto requirement for auditors to break client confidentiality.

b) Other PAs in public practice and their clients; and

As explained in our accompanying letter, we believe that the proposals that would allow other PAs to breach client confidentiality in some circumstances, together with the lack of clarity as to what and when PAs might report externally, creates considerable uncertainty. It is this uncertainty that we believe will trigger the unintended consequences, including potential move from professional accountants subject to the Code to others (in some cases perhaps less qualified) who are not.

c) PAIBs and their employing organizations.

We have chosen not to comment on PAs not in public practice.

Specific Matters

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

We agree with the proposed objectives (a) and (b) of paragraph 225.3. Whilst we agree in principle with the intention of (c), we are concerned that the term “public interest” may make it open to overly wide and divergent interpretation, as there is no definitive understanding of what “public interest” entails. Even when laws are in place the interpretation of the term “public interest” is not necessarily clear (see the publication “Accountancy” for June 2015 p. 49-50 on the issue of “public interest whistle blower test”, where impact on 100 fellow managers was deemed sufficient to meet the public interest test under the UK Public Interest Disclosure Act by an employment appeal tribunal).

Perceptions as to what “action needed in the public interest” actually constitutes in any given situation will depend on the specific situation and is also highly subjective. We refer to our comments elsewhere in respect of the potential for unintended consequences associated with the Board’s intention to “allow” disclosure to an external authority.

Thus, although various aspects of this particular proposal may be in the public interest, other aspects may be detrimental to the public interest. It may be more appropriate to word this part of the objective as being generally in the public interest or overall in the public interest, and to point out that what is or is not in the public interest will depend on a number of factors as well as being highly subjective. We also refer to our response to q. 3 in this regard.

Furthermore, the need to have exceptions or “scope outs” in the Code itself (see below) and through national legislation also calls into question whether the proposed objectives are entirely appropriate to the profession as a whole.

Proposed Exclusions

As discussed elsewhere in this letter, national law will often represent a scope out for some aspects. However, from a practicality viewpoint we certainly would agree with the proposed scope out for PAs performing due diligence engagements as explained in paragraph 35 of the Explanatory Memorandum. We also share the concerns of others expressed in relation to forensic accounting, which the IESBA is not proposing be scoped out.

We do, however, fail to see how excluding PAs undertaking work for which they have no direct engagement fits in with the Board’s stated objectives, since the proposed scope out will ensure that these PAs do indeed turn a blind eye to identified or suspected NOCLAR (see paragraphs.13 and 15 of the Explanatory Memorandum).

Requiring that PAs do not turn a blind eye on all but those situations where they have an indirect engagement is likely to lead to public misunderstanding as to the “integrity” of the profession when viewed as a whole.

Given these and other concerns, we do not conclude that the proposed objectives are entirely suitable.

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

We agree that it is appropriate for auditors to be governed by ISA 250 as to the description of laws and regulations applicable for the purposes of the Code (paragraph 22 of the Explanatory Memorandum).

However, we continue to take issue with the explanation in paragraph 29 of the Explanatory Memorandum and proposed paragraph 225.7 of the Code which seek to extend instances of NOCLAR under the Code beyond the auditor’s mandate under ISA 250 (i.e., moving beyond the impact on the financial statements to include substantial harm to the wider public). Whilst we appreciate that the IESBA is now proposing to limit the scope of matters that would be reported externally to serious instances of NOCLAR with a public interest connotation, we continue to believe that this aspect of the proposals introduces a lot of uncertainty as to the scope of NOCLAR as well as detectability by the

auditor, which, at best, will lead to an expectations' gap and at worst could have serious implications for the accountancy profession as already discussed.

Indeed, we were interested to note an example of such an expectation that has already come to the Board's attention. Paragraph 28 of the Explanatory Memorandum explains that the Board was made aware of expectations as to insider trading, and has stated that insider trading is generally extremely difficult to prove in practice. Nevertheless, the Board is now proposing to add laws and regulations that deal with securities markets and trading to the list of examples in paragraph 225.5 to address the comment received, without mention of these associated difficulties at all. Indeed, following the argument the Board has put forward in paragraph 34 of the Explanatory Memorandum as to thresholds, we are not convinced that laws and regulations that deal with securities markets and trading will generally fall into either category defined in paragraph 225.7, other than perhaps in relation to entities in the investment industry, and do not agree that this can be regarded as a general example in this context.

If the Board decides to retain its proposed stance in this area, there needs – in line with ISA 250.07 – to be a clear distinction between those matters an auditor could generally be expected to identify (i.e., as described in ISA 250.06(a)), those matters an auditor may generally be expected to identify (i.e., as described in ISA 250.06(b)), and those that may be far less likely to be identified during the course of an audit (i.e., as mentioned in ISA 250.08 and .15). ISA 250.05 explains the possible impact of inherent limitations of the audit on the auditor's ability to detect non-compliance in the performance of the audit. We note that the IESBA is not proposing to acknowledge these in the Code, but believe that a better understanding of such limitations is needed to reduce unrealistic expectations in this area.

We have commented in our response to q. 6 below in regard to the suitability of this scope for PAs other than auditors.

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

We accept that a differential approach is needed. However we do not fully agree with the proposals as to how this would be achieved.

We agree that the scope of NOCLAR for PAs other than auditors should not go beyond the "ISA 250 scope". However, we believe that proposing to use this for all PAs, regardless of their roles and levels of seniority (paragraph 22) may be

problematical in terms of public expectations as to the capability of the accounting profession as a whole. It is essential that the public understand that whilst statutory auditors have an audit mandate that means it is reasonable to anticipate that they *may* (in this context, we refer to our response to q. 5 in regard to the inherent limitations of an audit) be in a position to identify NOCLAR in such areas, for other PAs any ability to identify NOCLAR is intrinsically less since it is directly linked to the nature and scope of their individual roles.

We note that the proposed requirement in paragraph 225.34 contains the following limitation: “if, in the course of providing a professional service to a client, the PA becomes aware of information concerning an instance of NOCLAR or suspected NOCLAR…” and believe that this limitation will need to be clearer in the subsection entitled “scope” (paragraphs 225.5-.8).

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?*

No.

Whilst our response relates only to auditors, we suspect the concerns we raise would equally apply to senior PAIBs.

The factors are – necessarily in an international Code such as the IESBA Code – too vague and subjective in nature, and the interaction between the factors makes the required determination highly complex for auditors, their legal advisors, regulators or relevant professional bodies whom the auditor consults on a confidential basis and all other interested parties. For example, “urgency of the matter” is not always clearly discernable. What degree of urgency would “cross the threshold”? Under the Code there is no mechanism parallel to case law to clarify such issues. In some more developed countries this may be less problematical, as it may even be appropriate to draw on similar case law, but in many countries this type of issue will be highly problematical and will likely mean that this aspect of the Code proves unworkable.

The entire responsibility for reaching a “correct” determination is forced on the professional judgement of the auditor (possibly after consultation), who, as explained in our accompanying letter, is then wide open to claims from

whichever party believes it has suffered as a result of a possible wrong determination on the part of the auditor.

As we have already stated, in our view, such sensitive issues demand legal certainty and should be dealt with by legislation, and not by the IESBA Code.

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?*

No.

Whilst our response relates only to auditors, we suspect the concerns we raise would equally apply to senior PAIBs.

Given the discussion in paragraphs 50 et seq. of the Explanatory Memorandum we do not appreciate why IESBA is continuing to introduce the notion of public interest via the third party test in paragraph 225.25 and attempting to explain it (paragraph 225.4).

As noted in our accompanying letter, the third party test is one of the factors that, in certain circumstances, essentially “forces” a de facto requirement for an auditor to disclose to an authority notwithstanding that there is no legal or regulatory requirement to do so. We refer to our previous comments in this area.

In addition, the third party test is highly subjective, and the interpretation is likely to be impacted by cultural influences, which will lead to inconsistent application of the Code by auditors, audit regulators and courts of law. We refer to our letter dated December 12, 2012 in this context.

In conclusion, a requirement for auditors to make such a subjective judgement would be unworkable, not least as it would likely be unenforceable.

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?*

No.

Whilst our response relates only to auditors, we suspect the concerns we raise would equally apply to senior PAIBs.

As noted in our accompanying letter, providing disclosure as the only mutually exclusive course of action essentially “forces” a de facto requirement in certain

circumstances for an auditor to disclose to an authority notwithstanding that there is no legal or regulatory requirement to do so. We refer to our previous comments in this area.

If this were a straightforward issue, the IESBA would have proposed a variety of possible courses of action – and acknowledged that taking no action may be appropriate even if the "forced determination" indicated otherwise. Subject to our reservations as to the determination itself, resigning from the audit would appear to be an essential course of action, but may be precluded in some jurisdictions. As explained in the accompanying letter, we believe the Code should not deal with breaking client confidentiality beyond as required by relevant law and regulation.

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

No.

Whilst our response relates only to auditors, we suspect the concerns we raise would equally apply to senior PAIBs.

The factors are – necessarily in an international Code such as the IESBA Code – too vague and subjective in nature and the interaction between the factors makes the required determination highly complex for auditors, their legal advisors, regulators or relevant professional bodies whom the auditor consults on a confidential basis and all other interested parties. For example, what are the thresholds for judging when the actual or potential "harm to the interests of the client, investors, creditors, employees or the wider public" crosses the line in terms of its nature or of its extent or both? What is "an appropriate authority" in this context – does their track-record for taking action count or not in this determination or is it merely their existence? Given the sensitivity surrounding whistleblowing, does the existence of whistleblowing legislation alone count or should the auditor only disclose if satisfied as to its effectiveness? Under the Code there is no mechanism parallel to case law to clarify such issues.

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?

No.

In our view, as a matter of principle provisions requiring a PA to "consider" a matter are insufficiently clear. This term is notoriously difficult to translate, as it can have various different meanings in English ranging from the notion that a matter shall not be discounted to a deeper weighing up of multiple aspects of a matter. We note, for example, that the IAASB made a conscious decision to be more precise and avoid as far a possible requirements for auditors to consider matters.

We do not understand what justification the IESBA has in paragraph 225.40 in proposing that the existence of a network should trigger a consideration for the PA to inform the auditor of matters below the "further action required threshold", whereas when no network relationship exists the auditor would not be so informed. The nature and seriousness of the matter ought to be factors in such a consideration, not the nature of PAs relationships. Furthermore, the IESBA needs to be aware that client confidentiality provisions in law may also preclude compliance with paragraph 225.40.

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

Paragraph 225.32 extends the documentation requirements of ISA 250 when the auditor encounters an incidence of NOCLAR. It would be more appropriate to have this reflected within ISA 250 rather than auditors having to refer to two different sources for audit documentation.

We note that although paragraph 225.7 expands what the auditor shall regard as NOCLAR beyond ISA 250, the documentation requirements do not reflect a need to explain this. We suggest that in the event of a NOCLAR that is beyond the scope of ISA 250, it would likely be appropriate to document the facts and reason for inclusion.

In relation to PAs providing services other than audit, paragraph 225.48 does not require but instead "encourages" documentation, and then only when the NOCLAR "is a significant matter". Firstly, encouragement seems somewhat contrary to the Board's objectives with this project. Secondly, there needs to be some definition of the term "is a significant matter" in this context.

Request for General Comments

a) *PAIBs working in the public sector*— Recognizing that many PAIBs work in the public sector, the Board invites respondents from this constituency

to comment on the revised proposals and, in particular, on their applicability in a public sector environment.

In our opinion the concerns and considerations outlined above apply equally to PAIB's when they provide services in the public sector.

IDW members may be engaged to perform audits or other professional work in the public sector. An auditor in the public sector is required to report incidences of NOCLAR internally in the German long-form audit report, which is also provided to the relevant higher audit authority who has a statutory responsibility for following up on such matters. An auditor would not be permitted to break client confidentiality and report to an external authority.

b) *Developing Nations*—Recognizing that many developing nations have adopted or are in the process of adopting the Code, the Board invites respondents from these nations to comment on the proposals, and in particular, on any foreseeable difficulties in applying them in their environment.

N/A.

c) *Translations*—Recognizing that many respondents may intend to translate the final pronouncement for adoption in their environments, the Board welcomes comment on potential translation issues respondents may note in reviewing the revised proposals.

We have not fully considered the implications for translation and accordingly are not able to comment at this stage on every possible issue. However, we do note that the phrase "harm to the interests of the client, investors, creditors, employees or the wider public" contains the word "or", which we interpret to be meant in the sense of "and/or". This may be an issue requiring clarification on translation, as these factors might otherwise be interpreted as mutually exclusive. We also draw the Board's attention to difficulties in translating the term "consider"; as explained in our response to question 8.