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October 21, 2015

Ms. Kathleen Healy
Technical Director
International Auditing and Assurance
Standards Board
529 Fifth Avenue, 6th Floor
New York NY 10017, USA

by electronic submission through the IAASB website

Dear Ms. Healy,

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

We would like to thank you for the opportunity to provide the International Auditing and Assurance Standards Board (IAASB) with our comments on the Exposure Draft "Responding to Non-Compliance with Suspected Non-Compliance with Laws and Regulations" (hereinafter referred to as "the draft").

From our point of view, it is appropriate that the IAASB deal with the International Ethics Standards Board for Accountants (IESBA) Re-exposure Draft "Responding to Non-Compliance with Laws & Regulations" (IESBA NOCLAR). We also agree that ultimately, IAASB standards need to be aligned with the IESBA Code of Ethics (the Code). However, the fact that this issue needed re-exposure by the IESBA is indicative of how controversial the topic is. The IAASB is conspicuous by its absence in the public debate about non-compliance with laws and regulations (NOCLAR), even though many of the measures proposed in the IESBA NOCLAR will have a major impact on engagements performed in accordance with IAASB engagement standards.

We believe that the IAASB ought to have fully explored the merits or otherwise of the proposals as regard the potential impact on audit quality and other matters pertinent to the IAASB before forging ahead on the basis of the IESBA's proposals. This raises the question as to why the draft only deals with consequential amendments arising from NOCLAR, even though the IAASB has a responsibility to ensure that changes to the Code do not undermine its engagement standards. The

GESCHÄFTSFÜHRENDER VORSTAND:
Prof. Dr. Klaus-Peter Naumann,
WP StB, Sprecher des Vorstands;
Dr. Klaus-Peter Feld, WP StB;
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limitation of the draft to consequential amendments indicates that the IAASB has not engaged with the IESBA to ensure that the proposed changes to the Code are appropriate from an IAASB perspective. **We are therefore very concerned that the IAASB is limiting its treatment of NOCLAR to consequential amendments, rather than publicly engaging in the debate about the appropriateness of the proposed changes from an IAASB perspective. In our view, the IAASB needs to take responsibility for its standards by considering the impact of the IESBA NOCLAR on engagements performed in accordance with those standards and engaging with the IESBA on those matters.**

The IDW issued a very critical comment letter to the IESBA dated August 19, 2015 with respect to the re-exposure of NOCLAR. Some of the issues raised relate to matters of debate that are not directly relevant to the IAASB (we note in particular our view that reporting NOCLAR is a national legal matter that should not and cannot be adequately dealt with in international ethical standards): we will not repeat these in this comment letter. However, some matters in that letter are directly relevant to the IAASB, and therefore we will also address them in this letter. In addition, there are a few further matters of relevance to the IAASB that we did not mention in our comment letter to the IESBA that we will include in this letter.

In the body of this letter below we have addressed these matters of overarching importance to the IAASB. We have provided our responses to the questions posed in the Explanatory Memorandum in the Appendix to this comment letter. Additional comments by paragraph and additional items that we have identified for IESBA are also included in the Appendix to this comment letter.

Overarching issues in the IESBA NOCLAR re-exposure of direct relevance to the IAASB

I. Use of the public interest test

In proposed 225.3 (c), 225.4, 225.17(c), and 225.25 in the IESBA NOCLAR, the IESBA introduces a “public interest test” to determine whether the professional accountant has acted appropriately. ***The introduction of this test turns standards setting for the profession upside down and sets an atrocious standards setting precedent that will have a major impact on standards setting in the IAASB.*** We have absolutely no quarrel with, and in fact support, the principle that the raison d’être of the genesis and continued existence of the accountancy profession is its public interest role: we therefore completely support the central role given the public interest in 100.1 of the Code. However,

given the nebulous nature of the concept of "public interest", an individual professional accountant or an accountancy oversight authority is not in a position to determine whether or not a professional accountant has acted in the public interest in a particular instance, which may lead to audit oversight authorities second-guessing auditors as to what is in the public interest without suitable criteria (standards) to do so. In fact, a "public interest test" is likely not enforceable or actionable in most jurisdictions of which we are aware.[1]

Standards setters and the profession issue pronouncements precisely because requirements and guidance are needed to help guide professional accountants in their fulfillment of their public interest role. This implies that standards are written with input from a wide range of stakeholders so that professional accountants are able to fulfill the public interest by applying those standards. There is therefore a presumption (which can be rebutted) that the faithful application of the standards by a professional accountant means that the professional accountant has fulfilled the public interest in the circumstances. Any other presumption would undermine the role that standards and other pronouncements play in the activities of the profession. The IAASB's silence on this aspect of the IESBA's proposals appears to imply acceptance of its change in the overall standards setting approach. ***Hence, the IAASB needs to convey to the IESBA that by using the public interest test in such a central way, the IESBA undermines the role of standards in providing requirements and guidance as to how professional accountants should fulfill their public interest role.***

The IAASB did draw on the consideration of whether adverse consequences outweigh public interest benefits when determining whether a matter should be communicated as a key audit matter in ISA 701. However, this test applies only to extremely rare circumstances and is supported by three paragraphs (one of considerable length) of application material to help guide auditors in their determination. This was not an optimal solution, but it helped deal with a serious matter that occurs in extremely rare circumstances.

In contrast, in the proposed noted paragraphs, the IESBA is making the public interest test the centerpiece of auditors' (and hence audit oversight authorities') determinations of whether to report to an appropriate authority (i.e., it defines the "threshold"), which is the point of the entire NOCLAR project. For the

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[1] We also note that in discussions at the latest IAASB CAG meeting, advice received from a representative of the International Bar Association recommended that a requirement for firms to meet the public interest not be included in ISQC 1 because of potential unintended legal consequences. This argument applies equally to requirements in the IESBA Code.

reasons we note above, we believe that such a standards setting approach is fundamentally misguided. ***We therefore suggest the IAASB recommend to the IESBA that 225.3 (c), 255.4, 225.17 (c) and 225.25 in the IESBA NOCLAR be deleted.*** The other requirements and guidance subsequent to 225.25 are, in large measure, useful and do help auditors determine whether or not to report, if one introduces the right (and de facto obligation) to report (with which we disagreed in our comment letter to the IESBA; see also our critical comments thereto below). We note that the requirements in relation to non-audit services do not include such a public interest test without any degradation of the requirements and guidance on the issues that may need to be considered when determining whether to report.

II. Impact on quality of engagements, including audit quality

Client confidentiality has long been a cornerstone of the 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 professional accountant in public practice is granted access to all information to provide the particular service and to ensure the quality of the service provided, including the quality of audits. This means that legislators have decided that the quality of the service provided is more important to the public interest than the right or duty of the professional accountant in public practice to report to regulators. The EU has now provided an exception to this for the audits of PIEs by including a requirement to report to authorities, but EU legislators have ostensibly decided that this is not the case for other statutory audits. We would like to point out that the IESBA's extension of this to statutory audits other than audits of PIEs is therefore likely to be illegal under EU law.

We would also like to point out that in many jurisdictions professional accountants are empowered to provide legal advice (in some jurisdictions this right may be more limited than in others) with concomitant legal privilege of greater or lesser degree. Such legal privilege is designed to enable effective legal counsel, which would be impossible if information were withheld by clients. With respect to assurance engagements and audits, without a belief by clients that auditors will not report information provided to them to third parties, including regulators, audit clients may be reticent about providing information to their auditors about matters with a risk of illegality, which will be detrimental to audit quality. Thus, we believe that the legal advice obtained by the IESBA (see paragraph 60 of the Explanatory Memorandum) holds equally true in relation to the current proposals.

Overall, we believe that the IAASB has a responsibility to communicate with the IESBA about the potential impact of a right to report on the quality of engagements performed under its engagement standards where no requirement or right to report exists under national law, including on the quality of audits.

III. Underlying presumption that all audits are statutory audits or PIE audits

Paragraph 41 of the IESBA NOCLAR Explanatory Memorandum justifies a differential approach between professional accountants performing audits of financial statements (auditors) and other professional accountants by suggesting that auditors should have a greater responsibility to take action to respond to identified or suspected NOCLAR than other professional accountants in public practice. The paragraph then goes on to state that this duly recognizes the particular nature of auditors' remits and the higher public expectations of them. Furthermore, paragraph 73 suggests that professional accountants in public practice generally have "narrower mandates" and a lower level of public reliance on the services they provide.

We believe it to be important that the IAASB point out that the vast majority of audits of financial statements performed worldwide (and in most countries, even if not all) are in fact not statutory audits – they are solely privately contracted audits without any statutory requirement (i.e., voluntary audits). In virtually all voluntary audits, the audited financial statements and the auditor's report thereon are never made public and are not subject to regulation. Distribution and use of the auditor's report is usually limited to certain specified users. This is particularly the case for audits of special purpose financial statements, but this also applies to most audits of general purpose financial statements**.** We note that even PIEs may have voluntary audits of special purpose financial statements (or elements thereof) that are provided to specific non-regulator users and are never made public. ***We believe that the IAASB needs to clarify with the IESBA as to why voluntary audits of financial statements involve any higher responsibilities to act, or higher public expectations, or even greater levels of reliance than, for example, a statutorily required review engagement on financial statements, statutorily required other assurance engagements (such as assurance engagements on compliance) or other statutorily required services, such as some expert opinions.*** Furthermore, paragraph 111 of the IESBA NOCLAR Explanatory Memorandum refers to requirements to report

NOCLAR in many jurisdictions based on an Appendix to the January 2015 IESBA Issues Paper. Any reasonable review of that Appendix shows that the legal provisions mentioned are almost always limited to statutory audits of financial statements of PIEs or statutory audits in general; the reference to the FATF refers solely to money-laundering and not to other cases of NOCLAR**. *It is therefore important for the IAASB to point out that the IESBA is therefore overstating the cases in which law and regulation require reporting with respect to NOCLAR beyond money laundering and audit of financial statements of PIEs – and is completely overstating the case for voluntary audits.***

Regulators and other users have a particular interest in certain kinds of statutory audits and, in particular, audits of general purpose financial statements of PIEs**. *It seems to us that the IAASB might need to explain to the IESBA that it appears that the IESBA is projecting these desires of regulators and other users with respect to statutory audits of complete sets of general purpose financial statements and, in particular, audits of such financial statements of public interest entities (PIEs) to audits of financial statements in general, without reasonable justification for doing so.***

When the IAASB was working on the Clarity Project, regulators engendered a discussion as to whether the IAASB ought to distinguish between statutory and voluntary audits. After investigating the issue, the IAASB concluded that it is difficult to determine how statutory audits are defined from one jurisdiction to another, and also concluded that because the level of assurance obtained does not vary between statutory and voluntary audits, there was no need to make a distinction. For the same reason, no distinction was made between audits of financial statements of PIEs, including listed entities, and other audits. However, the IAASB did distinguish communications between those charged with governance and auditors for audits of financial statements of listed entities from other such communication in other audits. Recently, the IAASB has also limited the required communication of key audit matters to audits of financial statements of listed entities. However, in both cases no distinction was drawn in other than communication or reporting by the auditor to those charged with governance or users.

We therefore do not recommend that the IESBA distinguish between statutory audits and voluntary audits, or between audits of financial statements of listed and non-listed entities. However, we note that the IESBA generally distinguishes between audits of financial statements of PIEs and non-PIEs for independence purposes.

In our comment letter to the IESBA, we take the view that reporting to third parties, including regulators, is not an ethical issue, but a legal one and that therefore the IESBA should not be issuing requirements and guidance in this area. However, if despite our arguments in his respect, the IESBA chooses to issue requirements and guidance in this matter, then, based on our arguments above, ***rather than distinguishing between audits and other services, we believe that the IAASB ought to consider conveying to the IESBA that it consider whether there needs to be a distinction between audits of complete sets of general purpose financial statements of PIEs, on the one hand, and other services provided by professional accountants in public practice, including other audits, on the other hand.*** Such an approach would align the responsibility to take action with the nature of auditors' remits and the higher public expectation of them in relation to PIEs. This would also align the treatment of reporting in audits to third parties with that in the EU and other major jurisdictions.

IV. Work effort on NOCLAR and lack of distinction in work effort by level of assurance

We believe it is imperative that the IAASB and IESBA ensure an appropriate alignment of the work efforts required by the Code and the ISAs and other IAASB engagement standards. In fact, the question arises why IESBA should be engaging in standards setting that increases practitioner work effort in engagements performed under IAASB engagement standards at all.

We believe the IAASB needs to convey to the IESBA, that the IESBA has crossed the line from setting standards for ethical requirements to the IAASB's remit for setting standards for "investigative" engagements that involve additional work effort, such as assurance engagements and other related services, and is expanding the scope of such engagements "through the back door" by introducing a kind of "investigation" of NOCLAR. In doing so, reporting in relation to NOCLAR (whether to management, those charged with governance, or third parties, such as authorities), ceases to be derivative reporting (that is, reporting on matters not related to the engagement that have been identified during that engagement without any further investigation), but becomes reporting on the basis of some kind of investigation like an assurance engagement. We will address the issues we have identified below for three kinds of engagements: audits, other assurance engagements, and non-assurance engagements. We note that in this case there might need to be a distinction between professional

accountants in public practice and those in business (particularly those in management positions), the latter for which further investigation is actually part of their management or senior employee responsibilities.

a) Work effort on NOCLAR in relation to audits

Under ISA 250, the auditor's understanding of the laws and regulations is limited to ISA 250.12 (a general understanding of the legal and regulatory framework applicable to the entity) and ISA 250.13 (a greater understanding of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements needed to obtain sufficient appropriate audit evidence regarding compliance therewith). 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. Hence the auditor's initial understanding of laws and regulations without a direct effect is limited to ISA 250.12, rather than the in-depth understanding required by ISA 250.13. The procedures an auditor is required to perform beyond obtaining a written representation from management are limited in ISA 250.14 to laws and regulations that have a direct effect on the financial statements: the auditor need only remain alert for other instances of non-compliance with laws and regulations.

Only when the auditor becomes aware of non-compliance or suspected non-compliance does the auditor have a responsibility under ISA 250.18 to obtain an understanding of the nature of the act and the circumstances in which it has occurred. The auditor also has the responsibility to obtain further information to evaluate the possible effect on the financial statements – but only insofar as there is a possible effect on the financial statements. ISA 250.19 then requires the auditor to discuss the matter with management; only if the information provided by management is insufficient and the effect may be material to the financial statements does the auditor need to engage in further action (obtain legal advice, evaluation of impact on rest of audit, etc.). 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 thereon to determine whether to engage in further action.

In contrast, paragraph 225.11 of the ED IESBA Code proposes the auditor be required to obtain a more comprehensive understanding of the matter by 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, even if such laws have no material impact on the financial statements.

The understanding of the nature of the act and the circumstances in which it has occurred under ISA 250.18 (c) is driven by the auditor's concern that noncompliance with laws or regulations without a direct effect may have a material effect on the financial statements, and only for these does the auditor obtain further information. IESBA NOCLAR 225.11, on the other hand, is driven solely by the potential for "further action", particularly the "right to report". If some of these further actions beyond those contemplated by ISA 250 are not relevant, and this right does not exist (as in some jurisdictions), what does that imply for the nature and extent of understanding required when noncompliance with certain laws or regulations will not have a material impact on the financial statements under audit? What is the purpose of the understanding in these cases?

The deeper understanding required by IESBA NOCLAR covers not only laws and regulations that have a direct impact on the financial statements, or noncompliance with laws and regulations that may materially affect the financial statements, but also non-compliance with laws and regulation that would not have a material impact on the financial statements. By increasing the depth of understanding of these laws and regulations, the IESBA NOCLAR drives the auditor towards performing assurance-type procedures to obtain that understanding, even though such cases of noncompliance may not have any material impact on the financial statements. Hence, IESBA NOCLAR expands the scope of the audit beyond the risk-based approach of ISA 250 (that is, directed towards the risk of material misstatement in the financial statements) by having auditors obtain an understanding beyond any relationship to risk – the question arises – risk of what? This implies that any reporting (whether to management, those charged with governance, or third parties) in relation to noncompliance with laws and regulations that have no material impact on the financial statements would no longer be derivative reporting, but reporting based upon some form of investigation through the performance of further procedures.

Hence, the IESBA NOCLAR is requiring auditors to undertake investigations of noncompliance with laws or regulations even when the resulting understanding is irrelevant to the audit in question. ***This implies that the IESBA is changing the scope of an audit for non-compliance with laws and regulations without any material impact on the financial statements (i.e. matters***

irrelevant to the audit) to beyond derivative reporting (i.e., the IESBA is seeking some kind of comfort or assurance on NOCLAR). That the IAASB recognizes this is demonstrated by the content of proposed ISA 250.8a, .A12a, and .A17, as well as ISA 250.8a, which suggest that compliance with the Code will cause the auditor to have more information about noncompliance than would have been obtained through the audit alone. ***We believe that the IAASB needs to convey to the IESBA that the nature and extent of understanding for an audit needs to be driven by the needs of the audit – not by a potential need for further action by the Code, including reporting to third parties, but that the understanding required by the audit would form the basis for any further action, including reporting, required by the Code.***

b) Work effort on NOCLAR in relation to non-audit assurance engagements

The responsibility to act needs to depend in part on the nature of the engagement. However, in this case what matters is not the audit vs. non-audit distinction, but the nature and extent of information or evidence that the engagement requires to enable the professional accountant in public practice to draw a conclusion, if any, or form an opinion. In this context, **we *believe that the IESBA has simply adopted aspects of the ISA 250 model (in particular aspects of ISA 250.18) to non-audit engagements – and in particular limited assurance engagements – without considering whether they are appropriate in those circumstances, and thereby has extended the scope of those engagements.***

This is exemplified through the requirement in IESBA NOCLAR 225.34 to obtain an understanding of a matter (the nature of the matter and the circumstances in which it has occurred or may occur, and the application of the relevant laws and regulations to the circumstances) when actual or suspected NOCLAR is identified. To use reviews of financial statements as an example for limited assurance engagements, ISRE 2400.A78 only recognizes the responsibility of the practitioner to obtain an understanding of laws and regulations that have a direct effect on the financial statements. Only if the practitioner becomes aware that non-compliance with other laws and regulations is likely to lead to a material misstatement is the practitioner required to obtain an understanding of other laws and regulations and the nature of the matter and the circumstances in which it has occurred or may occur. If the practitioner becomes aware of actual or suspected non-compliance with laws or regulations that are not likely to have a material effect on the financial statements, at most the practitioner will report these to management (or, if appropriate, those charged with governance)

in a derivative fashion without any further investigation. The IESBA NOCLAR extends this responsibility by requiring the practitioner to obtain an understanding, when actual or suspected NOCLAR is identified, to other laws and regulations and the nature of the matter and the circumstances in which it has occurred or may occur, that have no material impact on the financial statements, **which means that IESBA NOCLAR requires a work effort beyond that which would be required for derivative report and thereby expands the scope of a review engagement.**

In addition, as noted, when actual or suspected NOCLAR is identified, the IESBA NOCLAR 225.34 requires the practitioner to obtain an understanding of the nature of the matter and the circumstances in which it has occurred or may occur. We would like to point out that a review engagement is based primarily on inquiry and analysis. Hence prior to undertaking his or her own investigation to obtain this understanding, in a review engagement the practitioner makes inquiries of management and where appropriate, those charged with governance prior to needing to perform further procedures. Furthermore, in a review engagement, in these cases a practitioner is required to perform procedures beyond inquiry only if the practitioner becomes aware of matter(s) that causes the practitioner to believe that the financial statements may be materially misstated, and then can be satisfied with the resulting evidence if he or she is able to conclude that the matter(s) is not likely to cause the financial statements to be materially misstated. In contrast, the IESBA NOCLAR 225.35 addresses a discussion with management *after* the practitioner investigates to obtain his or her own understanding. In addition, IESBA NOCLAR does not specify what the threshold is for further investigation or action once having discussed the matter with management or those charged with governance. These differences to ISRE 2400 also suggest that IESBA NOCLAR **requires a work effort beyond that which would be required for derivative report and thereby expands the scope of a review engagement.**

For these reasons, we believe that IESBA NOCLAR needs to clarify that once having made inquiries of management after having become aware of NOCLAR or suspected NOCLAR, when the results of those inquiries indicate that NOCLAR may cause the financial statements to be material misstated, the practitioner is required to perform additional procedures. When the practitioner concludes from the results of the inquiry that NOCLAR will not cause the financial statements to be materially misstated, then the auditor is not required to perform further procedures. If, however, the practitioner is not satisfied with the response in relation to NOCLAR even though NOCLAR will have no material

effect on the financial statements, then the practitioner needs to determine whether or not further action is necessary.

Based on this analysis, IESBA is changing the scope of a review to include noncompliance not relevant to the review (i.e., the IESBA is requiring some kind of comfort, assurance or investigation on NOCLAR). **The same applies to other reasonable (other than audits) and limited assurance engagements under IAASB engagement standards. The IAASB should convey this to the IESBA and seek to have IESBA limit any reporting to derivative reporting (if reporting is retained as an option), rather than requiring further investigation through the practitioner obtaining an understanding.**

c) Work effort on NOCLAR in relation to non-assurance engagements

In addition, we note that in a non-assurance engagement, a practitioner has no responsibility to gather evidence to support an opinion or conclusion. To use ISRS 4410 on compilation engagements as an example, the practitioner is required to gather only the information needed to draw up the financial statements and to request more information only if the information provided by management is incomplete, inaccurate, or otherwise unsatisfactory for the purposes of drawing up the financial statements**. *We believe it to be important that the IAASB point out that by requiring practitioners not performing assurance engagements under proposed 225.34 in the IESBA NOCLAR to obtain an understanding of the nature of the act and circumstances leading to (suspected) non-compliance and of the application of relevant laws and regulations, the IESBA is in fact requiring an investigation beyond simply requesting more information from management to resolve the matter based on the auditor's extant expertise and knowledge of the circumstances: "obtaining an understanding" of more than just the entity and its environment and of the applicable financial reporting framework to enable the professional accountant to compile the financial statements is in effect an assurance procedure for the purpose of gathering evidence about the (suspected) non-compliance.* In a non-assurance engagement, a professional accountant is entitled to accept information provided by management without further investigation unless, based on the professional accountant's *extant knowledge of the circumstances (including any applicable laws and regulations)*, such information appears incomplete, inaccurate or is otherwise unsatisfactory.**

For these reasons, we believe that the IAASB ought to convey to the IESBA that proposed 225.34 in the IESBA NOCLAR needs to be revised as follows for non-assurance engagements:

"If in the course of providing a non-assurance service to a client, the professional accountant becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws and regulations, the professional accountant shall seek additional information from management so as to enable the professional accountant to consider whether further action is needed. The professional accountant is entitled to accept information provided by management without further investigation unless, based on the professional accountant's extant knowledge of the circumstances (including of any applicable laws and regulations), such information is incomplete, inaccurate or is otherwise unsatisfactory."

The IAASB would then need to convey to the IESBA that the inclusion of this paragraph in 225.34 of the IESBA NOCLAR would obviate the need for 225.35 and 225.36.

V. Compatibility with requirements in IAASB Standards to comply with relevant ethical requirements

The proposals in the IESBA NOCLAR, 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, since IAASB Standards require compliance with relevant ethical requirements, which in turn is defined in relation to the IESBA Code.

For example, 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". Similar requirements and guidance exist in other IAASB engagement standards. As the Code becomes increasingly stringent – and thus will sometimes exceed national law with respect to the IESBA NOCLAR proposals, this issue will need to be addressed. Simply stating that the Code does not override local law or regulation does not resolve this issue, since local law or regulation may simply prohibit a professional accountant from fulfilling the Code and therefore would

be less restrictive than the Code. Furthermore, sometimes such restrictions result from court decisions, rather than being directly enshrined in legislative statutes or in regulation.

As the IESBA NOCLAR 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 or more than restrictive, or equally restrictive to the IESBA Code in the context of NOCLAR – 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 other practitioners and their compliance with the ISAs and other engagement standards in the event that national legal and regulatory requirements (including court decisions) are deemed less restrictive than the IESBA Code because they effectively prohibit requirements in the Code. We would like to point out that if the definition of compliance with the Code is too restrictive, there may be many jurisdictions that have currently adopted the ISAs that may no longer be in a position to do so.

As agreed with the technical director of the IESBA, we have provided a copy of this letter to the IESBA for further consideration.

We would be pleased to be of further assistance in these matters.

Yours truly,

Klaus-Peter Feld
Executive Director

Wolfgang Böhm
Director Assurance Standards,
International Affairs

494/584

APPENDIX

Responses to Request for Specific Comments

While the IAASB welcomes comments on all matters addressed in this ED, the IAASB is specifically seeking comments on the following matter *[sic]*

12. 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 refer to our letter for our views on the extension of the scope of IAASB engagements standards through the IESBA NOCLAR.

We believe that there is an imbalance in the amendments, in that often reference is made only to a "legal ethical duty or right" to report, when in many jurisdictions there may be a "legal prohibition" to report. Furthermore, the application material only dwells on a legal ethical duty or right to report and potential limitations on reporting to the management or those charged with governance due to "tipping off" restrictions, without consideration of some of the material in the IESBA NOCLAR about the legal and other risks that practitioners need to consider when making such a decision. In particular, the IESBA Code recognizes that there may be real legal risks involved in disclosure (legal liability due to breach of contract, tort, defamation, etc., not to mention physical risks in some jurisdictions). None of these other risks that the IESBA Code are addressed in the IAASB's exposure draft.

In our view, the following standards and paragraphs are too one-sided about the legal or ethical duty or right to report as opposed to an effective prohibition on reporting:

ISA 250.28, A.15, .A19 in the introductory sentence

ISQC 1.A56, .A65,

ISRE 3402.A53

ISA 250.A15 and .A19 ought to include more guidance on some of the legal and other risks that the IESBA NOCLAR identifies that the auditor needs to consider when deciding when to report. The same applies to ISA 240.A65.

Furthermore, we note that the following relatively new IAASB engagement standards have not included any amendments for the legal or ethical duty or right to report or prohibition on reporting:

ISRE 2410, ISAE 3000, ISAE 3410, ISAE 3420, ISRS 4410.

We also note that the older standards ISAE 3400 and ISAE 4400 have also not included such amendments, but understand that these may need general revision before such amendments are undertaken.

13. 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 requirements that would apply in those jurisdictions?

We refer to our letter to which this appendix is attached. In particular we refer to the section on the impact on quality of engagements, including audit quality, which notes that the IESBA NOCLAR reporting requirements may be illegal under EU law for other than audits of public interest entities (it would be illegal under German law). Furthermore, we refer to the section in our letter on the compatibility with requirements in IAASB Standards to comply with relevant ethical requirements, which addresses the situation when the Code is not applied, and what "at least as restrictive as the requirements in the Code" means in this respect, and what that may mean for the ability of auditors in Germany to claim compliance with the Code, and hence the ability to perform IAASB engagements.

18. Respondents are therefore asked for their comments, if any, on what further changes may be required to ISA 250 and why.

We are not aware of audit firms or audit inspections suggesting that ISA 250 is causing significant problems in practice. Furthermore, the issues identified in paragraph 16 of the explanatory memorandum suggest a wholesale revision of ISA 250, which does not appear to be appropriate at this time given the other projects on audit quality with a higher priority at this time. We suggest that the IAASB await the results of its consultation on the next Strategy and Work Plan before considering any further initiatives on ISA 250.

Comments by Paragraph

ISA 250.A5a When ISA 250 was clarified in the clarity project, the IAASB was exceedingly careful when it chose to address specific types of laws (see paragraph 2, paragraph 6 (a) and (b), and paragraphs A 8 and A9) that relate to the two categories of laws described in paragraph 6. In adding a list of laws and regulations in paragraph A5a, the IAASB is adding a list from the IESBA without consideration of how that list will be interpreted. The laws listed can be categorized, in whole or in part, into laws under 6 (a) or 6 (b) or both. Furthermore, the inclusion of this list will raise expectations about what auditors do with respect to those laws as part of the audit. This is particularly the case with laws relating to securities markets and trading (added by the IESBA in reaction to a comment received from IOSCO concerning insider trading) even though the IESBA noted that this is difficult to detect, it would very unlikely be detected as part of an audit of financial statements. This applies even more so to anti-trust legislation. We therefore strongly recommend that this list be deleted. Failing this, the introductory sentence should include the words “one or the other, or both” in between the words “included in” and “categories” after deleting “the”, to clarify that it is unclear how these laws might be categorized in particular circumstances. Furthermore, in this case a sentence should be added that in many cases the likelihood that an auditor would become aware of noncompliance or suspected noncompliance with these laws as part of an audit would generally be very low.

ISA 220.A8a Clarification ought to be provided that, contractually speaking, the predecessor auditor can only provide such information with a client waiver, unless law or regulation provides for the provision of such information without such a waiver.

ISQC 1.12 (o) We would like to point out that the wording in 140.7 (c) (iv) is not aligned with the wording in this paragraph of ISQC 1, which in our opinion is the correct wording.

Some additional detailed comments on the IESBA NOCLAR that the IAASB might wish to convey to the IESBA

225.10 The professional accountant should also obtain an understanding of those provisions in law or regulation that prohibit disclosure to third parties, including authorities, or that may cause serious legal risks to the professional accountant.

225.16 We would like to point out that legally-speaking, management at an entity that controls the client is in fact a third party, and not just another level of management within the entity. Consequently that last sentence in this paragraph belongs in the section on whether further action is needed.

225.21 In the last bullet point, consideration also needs to be given whether there may be substantial harm to the legitimate interests of the professional accountant or the profession, given the public interest role that professional accountants have.

225.33 If the professional accountant obtains the understanding noted in this paragraph because the engagement is an assurance engagement (see our comments above for non-assurance engagements), the professional accountant should also obtain an understanding of those provisions in law or regulation that prohibit disclosure to third parties, including authorities, or that may cause serious legal risks to the professional accountant.

225.44 We found some of the guidance in 225.44 about legal privilege to be particularly useful and ask ourselves why this guidance was not included in the section applicable to auditors.

140.7 We would like to point out that the wording in 140.7 (c) (iv) is not aligned with ISQC 1.12 (o).