

21 October 2015

Kathleen Healy  
Technical Director  
International Auditing and Assurance Standards Board  
545 Fifth Avenue, 14<sup>th</sup> Floor  
New York, 10017  
USA

Dear Kathy,

***IAASB Exposure Draft, Responding to Non-Compliance or Suspected Non-Compliance with Laws and Regulations.***

Thank you for the opportunity to comment on this Exposure Draft. We submit the feedback from the New Zealand Auditing and Assurance Standards Board (NZAuASB) in the attachment.

The NZAuASB commends the IAASB for working with the IESBA, tracking the IESBA NOCLAR project and working to address any actual or perceived inconsistencies between the IESBA Code and the International Standards on Auditing and other assurance standards in a timely manner, and aligning the comment periods so as to enable consideration in conjunction with the IESBA proposals. The NZAuASB's mandate covers both auditing and assurance standards, and includes ethical standards as they apply to assurance engagements. All efforts to co-ordinate and align terminology and requirements between the IAASB's assurance standards and the IESBA's ethical requirements as they apply to assurance engagements assists the NZAuASB in aligning all of the standards within the mandate of the NZAuASB with the international equivalents.

The NZAuASB's main concern with the NOCLAR project has been raised in its submission to the IESBA. That is, the NZAuASB considers that too much reliance or emphasis is placed on the obligations of the auditor, disproportionate to other professional accountants, and that the ethical obligations should be the same across all categories of professional accountants. The IAASB's *Framework for Audit Quality* demonstrates the importance of appropriate interactions among stakeholders and the importance of various contextual factors in ensuring quality audits. All members of the profession should therefore be subject to the same requirements and high standards to act in the public interest.

The NZAuASB is supportive of the proposed amendments by the IAASB but has identified some further suggestions where it considers further clarification could be made.

In formulation of this response, the NZAuASB has sought input from New Zealand constituents.

Should you have any queries concerning our submission please contact either myself at the address details provided below or Sylvia van Dyk ([sylvia.vandyk@xrb.govt.nz](mailto:sylvia.vandyk@xrb.govt.nz)).

Yours sincerely,

A handwritten signature in black ink, consisting of a large, stylized 'N' followed by a horizontal line that loops back under the 'N'.

**Neil Cherry**

**Chairman**

Email: [neil.cherry@xrb.govt.nz](mailto:neil.cherry@xrb.govt.nz)

## Submission of the New Zealand Auditing and Assurance Standards Board

### Exposure Draft *Responding to Non-Compliance or Suspected Non-Compliance with Laws and Regulations*

#### I Schedule of Responses to the IAASB's Specific Questions

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

**Response:**

The NZAuASB is supportive of the proposed limited amendments, although has identified some areas where it considers further clarification could be made.

In summary the NZAuASB considers that further clarification could be made between the legal duty to report, the legal or ethical right to report and the legal or ethical duty to maintain confidentiality. Detailed recommendations by standard follow:

#### **ISA 250 Consideration of Laws and Regulations in an Audit of Financial Statements**

*i. Documentation*

The NZAuASB notes that section 225.32 of the IESBA Code requires the auditor to document the judgements made in determining the appropriate actions where NOCLAR is identified.

We consider that documentation of the judgements made by the auditor in determining what action to take would improve the quality of the audit documentation required by ISA 250. Paragraph 29 of ISA 250 only requires documentation of identified or suspected NOCLAR and the results of discussions with management, those charged with governance and other parties outside the entity.

*ii. Examples of laws and regulations*

The IAASB has proposed to add paragraph A5a to include examples of laws and regulations to be considered by paragraph 6. The NZAuASB recommends:

- i. The examples in paragraph A5a should be categorised between the two categories of laws and regulations described in paragraph 6 of ISA 250 because the work effort differs accordingly;
- ii. The examples in paragraph 6 should be deleted if these and further examples are to be included in paragraph A5a.

Our recommendation is to amend paragraph 6 and proposed A5a as follows:

6. This ISA distinguishes the auditor's responsibilities in relation to compliance with two different categories of laws and regulations as follows:
  - (a) the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements ~~such as tax and pension laws and regulations~~ (see paragraph 13); and
  - (b) other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business, to an entity's ability to continue in its business, or to avoid material penalties ~~(for example, compliance with terms of the operating license, compliance with regulatory solvency requirements, or compliance with~~

~~environmental regulations~~), non-compliance with such laws and regulations may therefore have a material effect of the financial statements.

A5a. Examples of laws and regulations that may have a direct effect on the determination of material amounts and disclosures in the financial statements ~~be included in the categories~~ as described in paragraph 6(a) include those that deal with:

- Tax and pension liabilities and payments
- Securities markets and trading.
- Banking and other financial products and services.
- Fraud, corruption and bribery.
- Money laundering, terrorist financing and proceeds of crime.
- .

Examples of laws and regulations that may be fundamental to the operating aspects of the business, to an entity's ability to continue in its business, or to avoid material penalties and therefore may have a material effect on the financial statements ~~be included in the categories~~ as described in paragraph 6(b) include those that deal with:

- Terms of an operating license
- Solvency requirements
- Environmental protection
- Public health and safety.

iii. *Is there a breach of confidentiality?*

The NZAuASB considers that paragraph A19 of ISA 250 could be clarified further. The NZAuASB recommends that the bullets should separately deal with:

- 1) a duty to disclose;
- 2) a right to disclose; and
- 3) a duty or right to maintain confidentiality.

The NZAuASB considers that the duty of confidentiality always applies but is not considered to be breached where disclosure is made to appropriate parties in certain circumstances. The NZAuASB therefore considers that the first bullet point should be reworded to be more consistent with the IESBA code. We have the following suggestion for rewording:

- The auditor may have a legal duty to disclose identified or suspected non-compliance with laws and regulations to an appropriate authority without breaching the duty of confidentiality. ~~The duty of confidentiality may not apply or may be overridden by laws or regulations.~~ For example, 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.

As drafted, the last two bullet point seem to contradict each other, as one allows for reporting and the second implies that the duty of confidentiality prohibits reporting NOCLAR outside the entity. We recommend the last bullet point needs further clarification as to when it would apply in the context of the IESBA's proposals (or if it is intended to apply where other legal or ethical requirements apply) and also recommend the following changes to these bullet points:

- The auditor may have ~~the~~ a legal or ethical right to disclose identified or suspected non-compliance with laws or regulations to an appropriate authority without breaching the duty of confidentiality.

- In other circumstances, the auditor's legal or ethical duties to maintain confidentiality may preclude reporting identified or suspected non-compliance with laws and regulations to a party outside the entity.

### **ISA 240 The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements**

*i. Does the duty of confidentiality apply?*

The NZAuASB recommends that the requirement in para 43 of ISA 240 should be consistent with the requirement in para 28 of ISA 250 as follows:

43. If the auditor has identified or suspects a fraud, the auditor shall determine whether there is a legal or ethical responsibility-duty or right to report the occurrence or suspicion to a party outside the entity. ~~Although the relevant ethical requirements regarding maintaining confidentiality may preclude such reporting, in some circumstances the duty of confidentiality may not apply, be overridden by laws or regulations, or include a duty or right to report to an appropriate authority.~~

*ii. Communication with regulatory or enforcement authorities*

The NZAuASB prefers the three bullet point approach described above for ISA 250 paragraph A19 that is dealing with the legal right or duty to report, the ethical right or duty to report or the legal or ethical duty to maintain confidentiality to the proposed paragraph A65 in ISA 240. We consider this is more consistent with the IESBA code. As currently worded, para A65 may be read to imply that the professional or ethical duty may preclude reporting but this is overridden where the auditor has a legal responsibility. This overlooks that there may be an ethical duty to report. We recommend that paragraph A65 should be re-ordered as follows (no mark-up shown where text has been moved):

~~"Law or, regulation, or relevant ethical requirements~~ may include a duty ~~or right~~ to report to an appropriate authority without breaching the duty of confidentiality. In some ~~jurisdictions countries~~, the auditor of a financial institution has a statutory duty to report the occurrence of fraud to supervisory authorities. Also, in some ~~jurisdictions countries~~ the auditor has a duty to report misstatements to authorities in those cases where management and those charged with governance fail to take corrective action.

The auditor may have the legal or ethical right to disclose identified or suspected non-compliance with laws or regulations to an appropriate authority without breaching the duty of confidentiality<sup>1</sup>. ~~In other circumstances, the auditor's legal or ethical professional duties~~ to maintain the confidentiality of client information may preclude reporting fraud or other identified or suspected non-compliance with laws or regulations to a party outside the entity. ~~However, the auditor's legal responsibilities vary by country and, in certain circumstances, the duty of confidentiality may be overridden by laws or regulations. In certain circumstances,~~

### **ISRE 2400 (Revised)**

*i. Scope of laws and regulations*

Paragraph 48(d) of ISRE 2400 refers to the need for the practitioner to make enquiries about...

"the existence of any actual, suspected or alleged:

- fraud or illegal acts affecting the entity; and
- non-compliance with provisions of laws and regulations that are generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements, such as tax and pension laws and regulations.

<sup>1</sup> See, for example, Section 225.29 of the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code)

The NZAuASB considers that making enquiries regarding the second category of laws and regulations as outlined in ISA 250 paragraph 6 may be relevant in “affecting the entity”. The NZAuASB recommends that the second category of laws and regulations should be added to paragraph 48(d) and notes that this second category is covered by the scope of the IESBA’s ethical responsibilities. Aligning the scope in paragraph 48(d), as follows, may help to avoid any confusion:

“the existence of any actual, suspected or alleged:

- (i) ~~fraud or illegal acts~~ affecting the entity; ~~and~~
- (ii) non-compliance with provisions of laws and regulations that are generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements, such as tax and pension laws and regulations; ~~and~~
- (iii) other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business, to an entity’s ability to continue its business, or to avoid material penalties (for example, compliance with the terms of an operating license, compliance with regulatory solvency requirements, or compliance with environmental regulations) non-compliance with such laws and regulations may therefore have a material effect on the financial statements.”

ii. *Duty of confidentiality*

The NZAuASB recommends that paragraph 52 of ISRE 2400 (Revised) should be amended consistently with the wording in ISA 250 as follows:

“52(d) determine whether there is a legal or ethical duty or right ~~responsibility~~ to report the occurrence or suspicion of fraud or non-compliance ~~illegal acts~~ to a party outside the entity.

As highlighted above, the NZAuASB considers that the duty of confidentiality always applies but is not considered to be breached where disclosure is made to appropriate parties in certain circumstances. The NZAuASB also recommends that it would be clearer to separate the duty to disclose, the right to disclose or the duty or right to maintain confidentiality and therefore recommends that paragraph A92 should be reworded as follows:

- A92. Under this ISRE, if the practitioner has identified or suspects fraud or ~~illegal acts~~ non-compliance, the practitioner is required to determine whether there is a ~~responsibility~~ legal or ethical duty or right to report the occurrence or suspicion to a party outside the entity. The practitioner’s ethical, legal, and regulatory responsibilities vary by jurisdiction and, ~~in certain circumstances, the duty of confidentiality may not apply, be overridden by laws or regulations or law, regulation, or relevant ethical requirements may include a duty or right to report to an appropriate authority. Law or regulation may include a duty to report to an appropriate authority without breaching the duty of confidentiality.~~<sup>19</sup> In certain circumstances, the practitioner may have the legal or ethical right to disclose identified or suspected non-compliance with laws or regulations to an appropriate authority without breaching the duty of confidentiality. However, in other cases, the practitioner’s legal or ethical duties to maintain confidentiality may preclude reporting identified or suspected non-compliance with laws and regulations to a party outside the entity.

### **ISAE 3402 Assurance Reports on Controls at a Service Organisation**

The NZAuASB understands that the proposed IESBA framework, as it applies to assurance practitioners that are not auditors, identifies further actions (in proposed paragraph 255.43) that may provide the right to disclose the matter to the external auditor

or to an appropriate authority. The NZAuASB considers that the right to disclose the matter to the external auditor should also be covered in the guidance in ISAE 3402 (where the external auditor of the financial statements differs from the service auditor).

The NZAuASB therefore recommends the following change

A53. Appropriate actions to respond to the circumstances identified in paragraph 56 may include:

- Obtaining legal advice about the consequences of different courses of action.
- Communicating with those charged with governance of the service organization.
- Communicating with third parties (for example, a regulator or external auditor, where the external auditor or the financial statements differs from the service auditor) when required the auditor has a legal or ethical duty or right to do so.
- Modifying the service auditor's opinion, or adding an Other Matter paragraph.
- Withdrawing from the engagement.

The NZAuASB also recommends that the requirement in paragraph 56 should be amended for consistency as follows:

"If the service auditor becomes aware of non-compliance with laws and regulations, fraud, or uncorrected errors attributable to the service organisation that are not clearly trivial and may affect one or more user entities, the service auditor shall determine whether the matter has been communicated appropriately to affected user entities. If the matter has not been so communicated and the service organization is unwilling to do so, the service auditor shall determine whether there is a legal or ethical duty or right to report the occurrence to a party outside the service organisation and shall take appropriate action.

### **ISAE 3410**

The NZAuASB similarly recommends that consistent amendments should be made to paragraph 78 of ISAE 3410, which currently refers to the practitioner's "responsibility to report them to another party". As above, the NZAuASB recommends that this requirement should refer to the legal or ethical duty of right to report them to another party.

### **ISAE 3000 and the other ISAEs**

The NZAuASB is concerned that the proposed scope of the IESBA exposure draft differs from the scope of the requirements of the ISAEs. This concern has also been raised with the IESBA. The proposed scope of Section 225 of the IESBA Code applies to:

- (a) laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the client's financial statements; and
- (b) other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the client's financial statements, but compliance with which may be fundamental to the operating aspects of the client's business, to its ability to continue its business, or to avoid material penalties.

The focus of the requirements of the ISAEs is on subject matter information other than financial statements (for example paragraph A87 of ISAE 3410). The NZAuASB considers that this creates an inconsistency between the ethical requirements and the international standards. The NZAuASB has recommended to the IESBA that the scope of the laws and regulations in section 225 should be aligned to the subject matter of the engagement. If however, this change is not made, then the NZAuASB considers that there remains a perceived inconsistency between the international assurance standards and the proposed IESBA code.

*Extract from ISAE 3000 (Revised)*

45. The practitioner shall make inquiries of the appropriate party(ies) regarding:
- (a) Whether they have knowledge of any actual, suspected or alleged intentional misstatement or non-compliance with laws and regulations affecting the subject matter information; (Ref: Para. A101)

*Extract from ISAE 3410*

34. When performing the procedures required by paragraphs 33L or 33R, the practitioner shall consider at least the following factors: (Ref: Para. A84–A89)
- (a) The likelihood of intentional misstatement in the GHG statement; (Ref: Para. A84–A86)
  - (b) The likelihood of non-compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the content of the GHG statement; (Ref: Para. A87)
- A87 This ISAE distinguishes the practitioner’s responsibilities in relation to compliance with two different categories of law and regulation as follows:
- (a) The provisions of law and regulation generally recognized to have a direct effect on the determination of material amounts and disclosures in the GHG statement in that they determine the reported quantities and disclosures in an entity’s GHG statement. Paragraph 34(b) requires the practitioner to consider the likelihood of material misstatement due to non-compliance with the provisions of such law or regulation when performing the procedures required by paragraphs 33L or 33R; and
  - (a) Other law or regulation that do not have a direct effect on the determination of the quantities and disclosures in the GHG statement, but compliance with which may be fundamental to the operating aspects of the business, to an entity’s ability to continue its business, or to avoid material penalties (for example, compliance with the terms of an operating license, or compliance with environmental regulations). Planning and performing an engagement with professional scepticism, as required by ISAE 3000 (Revised), is important in the context of remaining alert to the possibility that procedures applied for the purpose of forming a conclusion on the GHG statement may bring instances of identified or suspected non-compliance with such law or regulation to the practitioner’s attention.

- 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 requirements that would apply in those jurisdictions?**

**Response:**

The NZAuASB is proposing to adopt the revisions to the IESBA Code in New Zealand once they have been finalised, therefore the proposed changes to the ISAs will not be incompatible with the ethical requirements in New Zealand.

**In addition to the requests for specific comments above, the IAASB is also seeking comments on the general matters set out below:**



- (a) 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.

**Response:**

The NZAuASB supports the proposed effective date.

**Other Comments**

As a minor comment, the NZAuASB recommends that clarification is required between a professional or ethical duty. The proposed amendments replace references to "professional duty" with "ethical duty" however there are additional places where "professional duty" remains. (For example ISA 240 paragraph 38 (a) refers to "Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities". Paragraph A65 still refers to "professional duty". For consistency, we recommend that these references should be amended to refer to ethical responsibilities consistently.

The NZAuASB also note that the term "illegal act" has been retained in some instances (ISA 260 paragraph 7, ISA 450 paragraph A8 and ISRE 2400 paragraph 52(d) and A92). For clarification and consistency, the NZAuASB recommend that the term "non-compliance with laws and regulations" should be used instead.