

**AMENDMENTS TO PROFESSIONAL AND ETHICAL STANDARD 1 (REVISED)  
RESPONDING TO NON-COMPLIANCE WITH LAWS AND REGULATIONS**

**Explanation of Decisions made by the NZAuASB in Finalising Amendments to  
Professional and Ethical Standard 1 (Revised) Responding to Non-Compliance with  
Laws and Regulations**

**Issued August 2016**

This document relates to, but does not form part of *Amendments to Professional and Ethical Standard 1 (Revised) Responding to Non-Compliance with Laws and Regulations* which was approved by the NZAuASB in August 2016.

This document is an explanatory document and has no legal status.

## **COPYRIGHT**

© External Reporting Board (“XRB”) 2016

This XRB explanatory document contains copyright material.

Reproduction in unaltered form (retaining this notice) is permitted for personal and non-commercial use subject to the inclusion of an acknowledgement of the source.

Requests and enquiries concerning reproduction and rights for commercial purposes within New Zealand should be addressed to the Chief Executive, External Reporting Board at the following email address: [enquiries@xrb.govt.nz](mailto:enquiries@xrb.govt.nz)

ISBN 978-0-947505-17-2

PROFESSIONAL AND ETHICAL STANDARD 1 (REVISED)

AMENDMENTS TO PROFESSIONAL AND ETHICAL STANDARD 1 (REVISED) RESPONDING TO NON-COMPLIANCE WITH LAWS AND REGULATIONS

Explanation of Decisions made by the NZAuASB in Finalising the Amendments

*Issued by the New Zealand Auditing and Assurance Standards Board*

CONTENTS

---

	Paragraph
<b>BACKGROUND</b> .....	1-6
<b>RATIONALE FOR AMENDMENTS MADE TO SECTION 225 OF THE IFAC CODE OF ETHICS</b>	
Expansion of the auditor’s framework to apply to all assurance engagements ...	7
<b>RATIONALE FOR FINAL DECISION TO CONVERGE WITH THE IFAC CODE</b>	
Scope.....	16

## **BACKGROUND**

1. In August 2012, the International Ethics Standard Board for Accountants (IESBA) issued an exposure draft *Responding to a Suspected Illegal Act* proposing that an auditor be required to disclose, where the client has not done so, to an appropriate authority suspected illegal acts that affect financial reporting or fall within the expertise of the auditor, and that are of such consequence that reporting would be in the public interest. The comment period closed in December 2012.
2. In May 2015, the IESBA issued a re-exposure draft entitled *Responding to Non-Compliance with Laws and Regulations (NOCLAR)*. The revised proposals set out a new framework to guide auditors, other professional accountants in public practice, and professional accountants in business in deciding how best to act in the public interest when they come across an act or suspected act of NOCLAR. The comment period closed in September 2015.
3. The IESBA received 77 responses, broadly supportive of the exposure draft, and considered the feedback from stakeholders at the December 2015 and March 2016 meetings. The IESBA approved the final provisions of section 225 and 360 of the Code of Ethics at the April 2016 IESBA meeting. After IFAC's due process, the amendments to the Code of Ethics were issued in July 2016.
4. The NZAuASB's strategic approach is to adopt international standards unless it identifies compelling reasons to modify the international standards for application in New Zealand. This policy is documented in the Principles of Convergence to International Standards of the International Auditing and Assurance Standards Board and to the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants (IESBA Code) which is available on the [XRB website](#). The NZAuASB identified limited need for compelling reason changes to the IESBA proposals and exposed two New Zealand exposure drafts (ED 2012-10 and ED 2015-3) to correspond with the IESBA consultation periods.
5. This document explains the rationale of the NZAuASB in finalising the New Zealand amendments to the Code of Ethics for Assurance Practitioners.
6. The New Zealand Auditing and Assurance Standards Board's (NZAuASB) mandate is limited to assurance engagements and therefore the scope of PES 1 (Revised) differs from the IFAC Code. PES 1 (Revised) is intended to apply to all assurance practitioners appointed or engaged to perform an assurance engagement. PES 1 (Revised) does not cover requirements for other professional accountants in public practice and does not cover Part C of the IFAC Code dealing with Professional Accountants in Business.

## **RATIONALE FOR AMENDMENTS MADE TO SECTION 225 OF THE IFAC CODE OF ETHICS**

### **Expansion of the auditor's framework to apply to all assurance engagements**

7. Section 225 is written to apply to Professional Accountants in Public Practice, and covers both assurance and other professional services. The IESBA has developed similar, but

separate responsibilities for professional accountants performing audits of financial statements as opposed to responsibilities when performing services other than audits of financial statements. The IESBA took into account differences between audits of financial statements and other services, noting that the provision of other services varies significantly around the world. Also, audits tend to be significantly more legislated or regulated than other professional services and other assurance engagements. The IESBA noted that jurisdictions would not be precluded from extending the requirements covering audits of financial statements to cover specific types of assurance engagements other than audits, should they believe that doing so would be appropriate for their national contexts.

8. The NZAuASB considers it appropriate to extend the requirements to cover all assurance engagements in New Zealand. In particular, the NZAuASB considers that the requirements should apply to reviews of financial statements. Due to recent legislative changes, certain registered charities can elect to have the financial statements reviewed instead of audited. The NZAuASB is of the view that it would be in the public interest for the assurance practitioner to respond in the same manner to an identified or suspected NOCLAR regardless of whether they were engaged to audit or review the financial statements.
9. In addition, the NZAuASB also considers in principle that in New Zealand it would be appropriate for all assurance engagements to follow the same framework for dealing with non-compliance with laws and regulations regardless of whether the subject matter of the engagement is the financial statements or some other subject specific matter. While other assurance engagements may not be as regulated, the NZAuASB is of the view that the same requirements are appropriate, when dealing with non-compliance with laws and regulations. These requirements should not be overly onerous, would enhance the quality of the assurance practitioner's response, and would be more consistent with the requirements of the other assurance standards and the expectations of the users of assurance reports. These modifications simplify the Code by making the requirements consistent for all assurance engagements (as applicable), and reducing repetition. The IESBA noted that "jurisdictions are not precluded from extending the framework for Professional Accountants in Public Practice (PAPPS) performing audits of financial statements to PAPPS performing other engagements if they believe doing so would serve their national interests<sup>1</sup>.
10. The NZAuASB has expanded the requirements applicable to audit engagements to apply to all assurance engagements and has not included the requirements for other professional services. The NZAuASB's mandate only covers assurance engagements, not other professional services. The NZAuASB is of the view that the requirements for audits of financial statements are appropriate for all assurance engagements and that the 'compelling reason' test has been met to expand these requirements to cover all assurance engagements. The frameworks are similar in many respects, i.e. the IESBA framework for professional accountants providing non-audit services repeats a number of requirements that apply to auditors.

---

<sup>1</sup> Basis for Conclusions: Responding to Non-Compliance with Laws and Regulations, paragraph 67

11. The impact of the decision to expand the requirements that apply to audits of financial statements to all assurance engagements is as follows:
- a. Paragraphs 225.39 – 225.56 have been excluded from PES 1 (Revised).
  - b. The following paragraphs apply to all assurance practitioners engaged to perform an assurance engagement, rather than just to assurance practitioners performing audits of financial statements:
    - i. The assurance practitioner shall obtain an understanding of the matter when they become aware of information concerning an instance of non-compliance (paragraph 225.12). This differs from paragraph 225.39 of the IFAC Code that requires that the professional accountant shall seek to obtain an understanding of the matter.
    - ii. Where the assurance practitioner believes that management is involved in the non-compliance, the assurance practitioner is required to discuss the matter with those charged with governance (paragraph 225.17). The IFAC Code is silent on where management is involved in the section on professional services other than audits of financial statements.
    - iii. The assurance practitioner shall advise management, and where appropriate those charged with governance to take appropriate and timely actions to rectify, remediate or mitigate the consequences of non-compliance, deter the commission of non-compliance or disclose the matter to an appropriate authority (as outlined in paragraph 225.18). This is in line with the objective of section 225, but is not explicitly covered by the section on professional services other than audits of financial statements.
    - iv. The assurance practitioner shall consider whether management or those charged with governance understand their legal or regulatory responsibilities with respect to the matter (paragraph 225.19).
    - v. The assurance practitioner shall comply with applicable laws and regulations governing the reporting of non-compliance with laws and regulations to an appropriate authority (paragraph 225.20).
    - vi. The assurance practitioner shall assess the appropriateness of management's response and additional factors to consider in assessing the appropriateness of the response (paragraphs 225.23-24) and additional factors to consider to determine what further action is necessary (paragraph 225.26).
    - vii. The assurance practitioner shall exercise professional judgement and take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances available, would be

likely to conclude that the assurance practitioner has acted appropriately in the public interest (paragraph 225.28).

- viii. Withdrawal is not a substitute for the assurance practitioner taking other actions (paragraph 225.30).
- ix. After withdrawal, the predecessor assurance practitioner shall provide all information to a successor accountant, when requested by the successor assurance practitioner, despite section 210.14 (paragraph 225.31).
- x. Additional guidance on when to disclose the matter to an appropriate authority has been included (paragraph 225.34).
- xi. The assurance practitioner will be subject to documentation requirements rather than being encouraged to document the matter (paragraph 225.37).

In each instance the NZAuASB is of the view that there are compelling reasons for the international standard to be broadened to apply to all assurance engagements. The modifications simplify the standard, making the framework consistent for all types of assurance engagements, avoiding unnecessary repetition in the Code of Ethics, and achieving consistency with the auditing and assurance standards. The guidance is considered equally relevant to all assurance engagements.

12. One key difference brought to the attention of the NZAuASB, through the New Zealand consultation process, was that access to those charged with governance may be restricted for other assurance engagements. The NZAuASB considered whether to amend the IESBA requirements for all assurance engagements to take into account that the assurance practitioner may not always have access to those charged with governance. The NZAuASB considered amending, paragraph NZ225.14.1, to require that the assurance practitioner discuss the matter with those charged with governance, if the assurance practitioner has access to those charged with governance.
13. The NZAuASB however agreed that this change was not needed. The auditor would always have access to those charged with governance, and discussing such matters with those charged with governance would be best practice in all other assurance engagements.
14. Where the IESBA requirements for professional services other than audits of financial statements address additional considerations, relevant to other assurance engagements, these paragraphs have been moved and labelled as NZ paragraphs. Specifically, the paragraphs dealing with the assurance practitioner's responsibilities to communicate the matter to the entity's external auditor have been moved and included in PES 1 (Revised) in paragraphs NZ225.17.1-5.
15. Paragraphs NZ225.21.1-22.1 dealing with communication with respect to group audits have been expanded to include review engagements of group financial

statements. This was not extended to all assurance engagements, as group audits relate specifically to financial statements.

## **RATIONALE FOR FINAL DECISION TO CONVERGE WITH THE IFAC CODE**

### **Scope**

16. Section 225 establishes the framework for an assurance practitioner to respond to non-compliance with the laws and regulations described in the scope, including laws and regulations that have a direct effect on the determination of material amounts in the client's financial statements and other laws and regulations which may be fundamental to the operating aspects of the client's business, its ability to continue as a going concern or to avoid material penalties.
17. The NZAuASB had proposed to amend the scope to refer to laws and regulations that have a direct effect on the subject matter information to cover the laws and regulations that may directly impact on the subject matter of an assurance engagement other than an audit or review of financial statements.
18. The IESBA noted in its Basis for Conclusions that a focus on laws and regulations that have a direct effect on the recognition or measurement of the subject matter in a non-audit assurance engagement could be unduly narrow, and could lead to the assurance practitioner not responding to non-compliance that may have a significant impact on the entity's financial statements, even where the assurance practitioner had recognised such an issue.
19. On further reflection, the NZAuASB agreed that the compelling reason test had not been met, due to the risk that any change could be misinterpreted as being narrower than the IESBA Code. In addition, the NZAuASB could not identify significant non-compliance related to the subject matter of a non-audit assurance engagement that will not have a significant impact on the entity's financial statements or its operations eventually (i.e. the non-compliance would be covered by paragraph 225 (b)). The NZAuASB therefore decided not to amend the scope to refer to laws and regulations that may directly impact on the subject matter of an assurance engagement other than an audit or review of financial statements, but to converge with the scope in the IESBA Code.