

## Exposure Draft

May 2015

*Comments due: September 4, 2015*

*International Ethics Standards Board for  
Accountants®*

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# Responding to Non- Compliance with Laws and Regulations

**IESBA**

International  
Ethics Standards  
Board for Accountants®



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Ethics Standards  
Board for Accountants®

The IESBA® is an independent standard-setting board that develops and issues high-quality ethical standards and other pronouncements for professional accountants worldwide. Through its activities, the IESBA develops the *Code of Ethics for Professional Accountants™*, which establishes ethical requirements for professional accountants.

The objective of the IESBA is to serve the public interest by setting high-quality ethical standards for professional accountants and by facilitating the convergence of international and national ethical standards, including auditor independence requirements, through the development of a robust, internationally appropriate code of ethics.

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## REQUEST FOR COMMENTS

This Exposure Draft, [Responding to Non-Compliance with Laws and Regulations](#), was developed and approved by the International Ethics Standards Board for Accountants® (IESBA®).

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by September 4, 2015.**

Respondents are asked to submit their comments electronically through the IESBA website, using the "[Submit a Comment](#)" link. Please submit comments in both a PDF and Word file. Also, please note that first-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website. Although IESBA prefers that comments are submitted via its website, comments can also be sent to Ken Siong, IESBA Technical Director at [KenSiong@ethicsboard.org](mailto:KenSiong@ethicsboard.org).

This publication may be downloaded from the IESBA website: [www.ethicsboard.org](http://www.ethicsboard.org). The approved text is published in the English language.

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# EXPLANATORY MEMORANDUM

## I. Introduction

1. This memorandum provides background to, and an explanation of, the proposed international ethics pronouncement addressing professional accountants' (PAs') response to non-compliance or suspected non-compliance with laws and regulations (NOCLAR). The International Ethics Standards Board for Accountants (IESBA, or the Board) approved the proposed pronouncement in April 2015 for re-exposure.
2. This proposed pronouncement comprises the following:
  - Section 225<sup>1</sup> concerning PAs in public practice;
  - Section 360<sup>2</sup> concerning PAs in business (PAIBs); and
  - Consequential and conforming amendments to other sections of the IESBA *Code of Ethics for Professional Accountants* (the Code).

## II. Background

3. In providing a professional service to a client or carrying out professional activities for an employer, a PA may come across an act or suspected act of NOCLAR. Such an act may have been committed or may be about to be committed by the client or employer, or by those charged with governance (TCWG), management or employees of the client or employer. The Board noted that the PA has a prima facie ethical responsibility not to turn a blind eye to the matter (see section III.A below). At the same time, the Board recognized that such a situation can often be a difficult and stressful one for the PA. The Board therefore approved this project in 2010 to develop enhancements to the Code to help guide the PA in dealing with the situation and in deciding how best to act in the public interest in these circumstances.<sup>3</sup>
4. Whether identified or suspected NOCLAR should be disclosed to an appropriate authority was one, although not the only, consideration in the project. Other matters that the project sought to address included:
  - The process for responding to identified or suspected NOCLAR;
  - The threshold for taking action; and
  - Documentation.
5. In August 2012, the Board issued an exposure draft (ED) of its proposals, [Responding to a Suspected Illegal Act](#). Overall, respondents were supportive of the Board exploring appropriate responses by PAs to instances of NOCLAR or suspected NOCLAR in the public interest. Respondents from the regulatory community, in particular, were supportive of the Board's efforts to provide guidance not only to auditors but also to PAs in public practice providing services other than audits of financial statements, and PAIBs.

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<sup>1</sup> Proposed Section 225, *Responding to Non-Compliance with Laws and Regulations*

<sup>2</sup> Proposed Section 360, *Responding to Non-Compliance with Laws and Regulations*

<sup>3</sup> The project proposal can be accessed [here](#).

6. There were, however, significant concerns across most stakeholder groups regarding the operability of the proposals, whether they were appropriately balanced, and the potential for unintended consequences.<sup>4</sup>
7. In the light of these substantive concerns, the Board held a series of three global roundtables in Hong Kong SAR, Brussels, Belgium, and Washington DC, USA, in May, June and July 2014, respectively. The aim of the roundtables was to solicit further views and input from stakeholders on the issues. Over 160 senior-level delegates from a wide range of stakeholder groups representing 27 jurisdictions, including 13 G-20 countries, participated in the roundtables, indicating the importance of, and high level of interest in, this topic. In addition, observers from the Public Interest Oversight Board (PIOB) and the International Auditing and Assurance Standards Board (IAASB), as well as the Chair of the IESBA Consultative Advisory Group (CAG), attended the events.
8. As a result of the significant comments on the ED, the roundtable input<sup>5</sup> and the Board's further deliberations and consultations with the IESBA CAG and other stakeholders, the Board has developed a revised approach for PAs to respond to instances of NOCLAR or suspected NOCLAR. This revised approach is reflected in the proposed response framework laid out in the diagrams in Appendix 1.
9. Since the comment period on the ED closed, the Board has consulted with the IESBA CAG on five occasions. The Board has also consulted separately with the regulatory community, national standard setters, the Forum of Firms, the IFAC Small and Medium Practices (SMP) Committee, the IFAC PAIB Committee, and IFAC member bodies, among others. The Board is also liaising with the IAASB on the project (see Section VI below).
10. The remainder of this memorandum is structured as follows:
  - III. Proposed response framework
  - IV. Strengths of the proposed framework
  - V. Broader considerations
  - VI. Liaison with IAASB
  - VII. Analysis of the overall impact of the proposals
  - VIII. Project timetable and effective date
  - IX. Guide for respondents

### **III. Proposed Response Framework**

11. This section explains the Board's rationale for the proposed framework and outlines the main elements of the framework. In developing this revised approach, the Board has kept in mind that the key objective of the project is to develop a framework that would guide PAs when they come across an act or suspected act of NOCLAR in deciding how best to act in the public interest in the circumstances.

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<sup>4</sup> A comprehensive summary of the significant comments on the ED can be accessed [here](#).

<sup>5</sup> A comprehensive summary of the roundtable input can be accessed [here](#).

12. For purposes of illustrating the application of the framework, Appendix 2 sets out a flow chart showing possible pathways to responding to suspected fraud, as one example of suspected NOCLAR, in the case of auditors.

**A. Objectives of Proposed Sections 225 and 360**

13. In deliberating the way forward in the light of the ED comments and the roundtable input, the Board has reflected on what objectives the two proposed Sections should set out to achieve. First, the Board believes it is to ensure that PAs do not turn a blind eye to identified or suspected NOCLAR and that they do not, through their actions or inaction, bring the profession into disrepute. Phrased in terms of the fundamental principles, the Board believes this objective should be to enable PAs to comply with the fundamental principles of integrity and professional behavior:

- Integrity – to be straightforward and honest in all professional and business relationships.
- Professional behavior – to comply with relevant laws and regulations and avoid any conduct that discredits the profession.

14. Secondly, it is, by alerting management or, where appropriate, TCWG, to seek to:

- (a) Enable them to rectify, remediate or mitigate the consequences of the NOCLAR or suspected NOCLAR; or
- (b) Deter the commission of the NOCLAR where it has not yet occurred.

15. And thirdly, it is for PAs to take such further action as may be needed in the public interest (see paragraphs 225.3 and 360.3). In this regard, the Board has proposed some guidance on factors to consider in determining what constitutes the public interest in the context of responding to identified or suspected NOCLAR (see paragraphs 225.4 and 360.4).

16. The Board believes that fulfilling these objectives will enable PAs to meet their overriding responsibility to act in the public interest. It also believes that setting out those objectives clearly at the beginning of the two Sections establishes the appropriate tone and context for what then follows in the rest of the Sections.

17. Identifying such objectives is consistent with advice the Board has received from some national standards setters about making clear upfront what is expected of PAs when they identify or suspect NOCLAR, i.e.:

- Fundamentally, PAs should not bring the profession into disrepute.
- Fundamentally also, the aim should be to bring about a change in behavior, not only with respect to PAs but also with respect to those with whom they interact, i.e. management and TCWG.

**B. Scope of the Revised Proposals**

18. The original ED classified the types of NOCLAR to be disclosed in the following three categories:

- For a PA in public practice providing services to an audit client:
  - NOCLARs that directly or indirectly affect the client's financial reporting; and
  - NOCLARs the subject matter of which falls within the PA's expertise.
- For a PA in public practice providing services to a non-audit client:

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- NOCLARs that relate to the subject matter of the professional services being provided by the PA.
  - For a PAIB:
    - NOCLARs that directly or indirectly affect the employing organization's financial reporting; and
    - NOCLARs the subject matter of which falls within the PA's expertise.
19. The Board tentatively proposed to remove these limitations mainly on the grounds that by not carrying forward the ED proposal to require disclosure of identified or suspected NOCLAR to an appropriate authority in specified circumstances (see paragraph 60 below), the PA should be free to disclose matters that are outside of the PA's expertise.
20. Significant concerns were expressed at the roundtables regarding what was now perceived to be a wide scope. These concerns were raised despite the proposed scope now being only in the context of a permission – and not a requirement – to override confidentiality under the Code to disclose identified or suspected NOCLAR to an appropriate authority. Therefore, consistent with the views of many at the roundtables, the Board has reconsidered what should reasonably be expected of PAs regarding the types of NOCLAR they should be concerned with, having regard to what should be within the scope of their professional training and expertise.
21. For auditors, International Standard on Auditing (ISA) 250<sup>6</sup> already establishes the scope of those laws and regulations that they should consider in their audit of the financial statements, i.e.:
- (a) The provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the 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 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.
22. As auditors are already expected to have a working knowledge of those two categories of laws and regulations relevant to their particular client, the Board believes that they should have regard to the same categories of laws and regulations *for purposes of the Code*. The Board further believes that those two categories should also represent an appropriate scope of laws and regulations covered for all other categories of PA. This is because it would be reasonable to expect them, by virtue of their professional training and expertise, and their knowledge of and experience with the entity (either through the provision of non-audit services to the entity or through an employment relationship), to recognize an act of NOCLAR or suspected NOCLAR in those two categories of laws and regulations if they came across it. This expectation would hold regardless of these other PAs' roles and levels of seniority. (See paragraphs 225.5 and 360.5.)
23. The Board believes that for all other laws and regulations, PAs are subject to the same ethical expectations as ordinary good citizens in responding to identified or suspected NOCLAR. Those other laws and regulations are therefore outside the scope of the proposed Sections.
24. In the light of the roundtable feedback, and particularly stakeholder concerns about making sure that the provisions are practicable and operable on a global basis, the Board believes that aligning the

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<sup>6</sup> ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*



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scope of laws and regulations covered by the revised proposals with that of ISA 250 is an appropriate way forward for the reasons noted above.

25. The Board also considered whether there should be a differentiation in the revised proposals depending on whether or not the entity is a public interest entity (PIE). The Board believes that issues of NOCLAR can arise in entities that are not PIEs just as well as in PIEs. Accordingly, in relation to the scope, the Board believes that there should not be a distinction between PIEs and entities that are not PIEs.

### EXAMPLES OF LAWS AND REGULATIONS ADDRESSED

26. The Board has set out in proposed Sections 225 and 360 some examples of laws and regulations which each Section would address under the two categories noted above (see paragraphs 225.6 and 360.6). Some laws and regulations may be fundamental to the operations of all or virtually all entities in a particular jurisdiction, for example, laws against fraud, corruption and bribery, and terrorist financing. Other laws and regulations may be relevant to only certain types of entity because of the nature of their business, for example, environmental protection regulations for an entity operating in the mining industry, and banking regulations for a bank. In addition, there will be laws and regulations that have a direct effect on the determination of material amounts and disclosures in an entity's financial statements, for example, laws and regulations that deal with tax and pension liabilities and payments.
27. In its consultations with the IESBA CAG and regulatory stakeholders, the Board received a suggestion that insider trading should be captured within the scope of the proposals. It was noted that while such NOCLAR may not necessarily result in any significant harm to the public or have direct or indirect effect on the financial statements, it may well undermine the reputation of the entity. For that reason, it was felt that there could still be a significant adverse impact from a public interest perspective.
28. The Board noted that insider trading is generally extremely difficult to prove in practice. Nevertheless, in response to this suggestion, the Board has added in the list of examples a reference to laws and regulations that deal with securities markets and trading, which ordinarily address such a matter (see paragraphs 225.6 and 360.6). The Board believes that if insider trading has occurred at an entity level through the involvement of management or TCWG, there could be potential adverse consequences in terms of substantial fines on the entity, thereby indirectly harming the entity's shareholders.

### RELATIONSHIP WITH ISA 250

29. While the scope of laws and regulations covered by the proposed pronouncement is similar to that of ISA 250, nothing in the proposals is intended to modify or interpret that or other ISAs. The proposals are intended instead to complement the ISAs. In regard to the scope of laws and regulations covered, the *application* of the proposals differs from the application of the ISAs in the context of the different objectives of the Code and the ISAs. Specifically, under ISA 250, auditors will be concerned with the consequences of identified or suspected NOCLAR in terms of whether it has a material effect on the financial statements. This concern will apply equally for purposes of the Code given the need for auditors to have regard to the consequences for the entity (paragraphs 225.4(b) and 225.7, first sentence). Where the proposed pronouncement goes beyond ISA 250, however, is to call for auditors and other PAs to have regard to the *wider public interest implications* of the matter in terms of potentially substantial harm to stakeholders, whether in financial or non-financial terms. The Board

believes that this is consistent with the ethical remit of the Code. Paragraphs 225.7 and 360.7 explain this important distinction and provide examples of NOCLAR that illustrate the point. Paragraphs 225.21 and 360.20, last bullets, explain the meaning of the concept of “substantial harm” (see also paragraphs 50-53 in subsection C(a) below).

#### MATTERS SCOPED OUT

##### *Clearly Inconsequential Matters*

30. In formulating revised proposals for purposes of the roundtables, the Board had tentatively proposed to require that if the PA becomes aware of information concerning an instance of NOCLAR or suspected NOCLAR *and the matter is other than clearly inconsequential*, the PA seek to obtain an understanding of the matter.
31. Many of the roundtable participants felt that the threshold of clearly inconsequential was too low. There were also concerns that tied to the very first requirement in the process to respond to the matter, this threshold could prompt the PA to seek legal advice in almost every case.
32. The Board believes that the perception about the threshold being very low may have arisen because it was directly linked to the requirement to seek to obtain an understanding of the matter. Rather, the Board is of the view that at the point of coming across information concerning NOCLAR or suspected NOCLAR, the PA would not be in a position to assess the potential consequences of the matter without *first* having obtained an understanding of it. Accordingly, other than when the matter is *clearly* inconsequential, the PA ought to seek to obtain that understanding to be able to make an assessment of those consequences.
33. To make this clearer and to address stakeholders’ concerns, the Board proposes to remove the threshold from the requirement to seek to obtain an understanding of the matter. The Board proposes instead to simply scope out matters that are clearly inconsequential from the two proposed Sections. These matters may include, for example, petty pilferages or minor traffic contraventions for employees whose work responsibilities include delivery of goods. To respond to feedback from the roundtables, the Board has also proposed guidance regarding factors to be taken into account by the PA in determining whether a matter is “clearly inconsequential” (see paragraphs 225.8(a) and 360.8(a)).
34. During the Board’s deliberations, an observation was made that the description of the two categories of laws and regulations addressed by the proposed pronouncement appeared to already contain implicit thresholds (i.e., “*material* amounts and disclosures” and “*fundamental* to the operating aspects of the business”) that would be significantly higher than “clearly inconsequential.” On reflection, the Board noted that the former are linked more to the nature of the laws and regulations themselves than to actual instances of NOCLAR or suspected NOCLAR. Accordingly, the Board determined that there is no inconsistency.

##### *Personal Misconduct*

35. Consistent with the original ED, the revised proposals scope out personal misconduct unrelated to the business activities of the client or employing organization (see paragraphs 225.8(b) and 360.8(b)).

*Other Exclusions*

36. The revised proposals are intended to cover only situations where the PA has a direct (contractual) relationship with a client (such as through an audit or other assurance engagement or the provision of non-assurance services), or, for PAIBs, where there is an employment relationship. The proposals are not intended to apply to circumstances where the PA has no direct relationship with the party suspected of committing an act contrary to prevailing laws or regulations. These include, for example, circumstances where a PA has been engaged by a client to perform a due diligence assignment on a third party entity and the identified or suspected NOCLAR has been committed by that third party.
37. Accordingly, for the avoidance of doubt, paragraphs 225.8(c) and 360.8(c) make clear that NOCLAR committed by persons other than the client or employing organization, or TCWG, management or employees of the client or employing organization, is out of scope. The Board, however, believes that PAs may find the guidance in those two Sections helpful in considering how to respond in these situations, and has indicated so in those paragraphs.

**C. Approach to Responding to Identified or Suspected NOCLAR**

38. One of the key insights from the roundtables was that the basic ethical principles should be the same for all PAs, i.e., they should respond to the issue and not turn a blind eye. However, the implementation of those principles will differ depending on their roles, levels of seniority and spheres of influence.
39. Recognizing this, the Board has developed a differential approach to responding to identified or suspected NOCLAR under the proposed framework for the following four categories of PA:
  - Auditors
  - Senior PAIBs
  - PAs in public practice providing services other than audits
  - Other PAIBs

40. The following subsections explain the approach with respect to each category of PA.

(a) AUDITORS

41. Taking into account the feedback from the roundtables, the Board believes that auditors should have a greater responsibility to take action to respond to identified or suspected NOCLAR than other PAs in public practice. This duly recognizes the particular nature of auditors' remit and the higher public expectations of them. Accordingly, the Board proposes that auditors be required to take the actions set out below.

*Understanding the Matter and Addressing It with Management and TCWG*

42. First, auditors must obtain an understanding of the matter if, in performing the audit, they become aware of information that suggests NOCLAR or suspected NOCLAR (see paragraph 225.11). This is consistent with ISA 250 and is a prerequisite to assessing the potential consequences of the matter to the entity or stakeholders.
43. Also consistent with ISA 250, auditors must raise the matter with management and, where appropriate, TCWG if they then suspect that NOCLAR has occurred or may occur. This discussion would enable auditors to clarify their understanding of the matter with management or TCWG,

including the potential consequences of the matter (see paragraphs 225.12-13). In practice, the situation will often be resolved through such discussion and, if necessary, through escalating the matter to higher levels of management and, ultimately, to TCWG (paragraphs 225.15-16). Importantly, as emphasized by a number of roundtable participants from the governance community, in most instances TCWG will take their responsibilities seriously and will investigate the matter (paragraph 225.13).

44. However, the Board believes that it is appropriate for the Code to go beyond ISA 250 if management and, where appropriate, TCWG agree that an instance of NOCLAR has occurred or may occur *and they have not taken appropriate and timely actions*. The Board proposes that in those circumstances auditors prompt them to take such actions. These actions include:
- Rectifying, remediating or mitigating the consequences of the NOCLAR.
  - Deterring the commission of the NOCLAR where it has not yet occurred.
  - Disclosing the matter to an appropriate authority where required by law or regulation, or where considered necessary in the public interest. (See paragraph 225.17.)
45. The Board believes that these steps achieve two important goals:
- Making clear that substantiation of the facts must take place early in the process.
  - Placing a necessary emphasis on management and, where appropriate, TCWG stepping up to their responsibilities to address the matter.
46. At the same time, auditors must fulfill their own responsibilities. These will include:
- Understanding and complying with applicable laws and regulations in the circumstances, which may mandate that the matter be reported to an appropriate authority. (See paragraphs 225.10 and 225.19.)
  - Complying with professional standards, including communicating the matter with TCWG, as already required under ISA 250, and considering the implications for the auditor's report. (See paragraph 225.19.)

*Determining Whether Further Action is Needed*

47. In the vast majority of cases in practice, management and, where appropriate, TCWG will fulfill their responsibilities upon being informed of identified or suspected NOCLAR. In a minority of cases, however, raising the matter with management or TCWG may be insufficient if they do not appropriately respond to the matter. In those cases, auditors must determine if further action would be needed to enable them to achieve their objectives under the proposed Section (see paragraph 225.20).
48. Whether such further action is needed, and the nature and extent of it, will depend on a variety of factors, starting with a consideration of the legal and regulatory framework. Other factors include:
- The appropriateness and timeliness of the response of management and, where applicable, TCWG.
  - The urgency and pervasiveness of the matter.
  - Whether there can be continued confidence in the integrity of management and, where applicable, TCWG.

- Whether the NOCLAR or suspected NOCLAR is likely to recur.
  - Whether there is credible evidence of actual or potential substantial harm to the interests of the entity, investors, creditors, employees or the wider public. (See paragraph 225.21.)
49. Possible courses of further action, which act as “pressure release valves” in these circumstances, may include:
- Disclosing the matter to an appropriate authority, even if there is no legal or regulatory requirement to do so.
  - Withdrawing from the engagement and the client relationship (where permitted by law or regulation). (See paragraph 225.24.)

*Threshold for the Determination of Further Action*

50. Many respondents to the ED were concerned about the proposal to use the public interest as the threshold for determining whether or not to disclose the matter to an appropriate authority. In particular, it was felt that the threshold was too broad and vague. It was also noted that the concept of public interest itself was undefined and little guidance had been provided as to how it should be applied.
51. In the light of these concerns, the Board tentatively proposed a different approach by referring to an assessment of the “gravity of the matter” as the primary factor influencing whether or not to disclose the matter to an appropriate authority. Many participants at the roundtables felt that this approach also was unsatisfactory because of a lack of clarity. Some roundtable participants, however, suggested consideration of the approach taken by the U.S. Securities and Exchange Commission (SEC) in its regulation governing the obligations of attorneys who learn of client misconduct. Specifically, a provision of the regulation permits (but does not require) attorneys representing issuers to breach their attorney-client confidentiality obligations as follows:

An attorney appearing and practicing before the Commission in the representation of an issuer may reveal to the Commission, without the issuer's consent, confidential information related to the representation to the extent the attorney reasonably believes necessary:

- (i) To prevent the issuer from committing a material violation that is likely to cause substantial injury to the financial interest or property of the issuer or investors;
  - (ii) To prevent the issuer, in a Commission investigation or administrative proceeding from committing perjury, proscribed in 18 U.S.C. 1621; suborning perjury, proscribed in 18 U.S.C. 1622; or committing any act proscribed in 18 U.S.C. 1001 that is likely to perpetrate a fraud upon the Commission; or
  - (iii) To rectify the consequences of a material violation by the issuer that caused, or may cause, substantial injury to the financial interest or property of the issuer or investors in the furtherance of which the attorney's services were used.<sup>7</sup>
52. Having considered this suggestion, the Board came to the view that the term “substantial injury” in the SEC regulation provides greater clarity and specificity than the concepts of gravity or public

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<sup>7</sup> U.S. SEC rule 17.C.F.R. Part 205—Standards of Professional Conduct for Attorneys Appearing and Practicing before the Commission in the Representation of an Issuer

interest. Further, a threshold of “substantial injury” sets an appropriately high hurdle for auditors to clear in determining the need for further action.

53. The Board therefore proposes to adopt this approach for the framework, but substituting “harm” for the term “injury” given that the latter is closely associated with physical injury in many languages other than English. The Board has also proposed guidance to explain that an act that causes substantial harm is one that results in serious adverse consequences to the entity, investors, creditors, employees or the wider public in financial or non-financial terms (see paragraph 225.21, last bullet). In this regard and for the avoidance of doubt, substantial harm to the entity includes material misstatement of the entity’s financial statements.

#### *Third Party Test*

54. To ensure an objective and rigorous assessment of the need for, and nature and extent of, further action, the Board is proposing that the framework require the application of a third party test. Under this test, auditors would be required to take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances available at the time, would be likely to conclude that they have acted appropriately in the public interest (see paragraph 225.25).
55. During the development of this third party test, the Board considered whether it would be more appropriate to position the test earlier in the process to help assess matters such as scope and threshold. There was a concern that if positioned at the end stage of the process, the test, combined with the “substantial harm” threshold, could create an expectation that auditors should disclose the NOCLAR or suspected NOCLAR to an appropriate authority.
56. After further reflection, the Board reaffirmed that the proposed placement of the test is appropriate. The Board noted that the focus of the test is not about whether to disclose the matter to an appropriate authority but about the *need for and nature and extent of further action*. Whether such further action would include disclosure to an appropriate authority would depend on an objective assessment of the facts and circumstances at the time, and not in hindsight. The Board believes that the test is important and necessary to ensure that there is a demanding assessment of such further action as may be needed to achieve the objectives under the Section. The establishment of this proposed test has been broadly supported by the IESBA CAG.

#### *Determining Whether to Disclose the Matter to an Appropriate Authority*

57. Whether disclosure to an appropriate authority would be a proper course of further action would depend *in particular* on the nature and extent of the actual or potential harm from the matter to the wider public, including the investing public, creditors or employees. In this regard, the Board has specified the purpose of making such a disclosure. The Board has also proposed some examples of circumstances where the auditor may determine that such disclosure is an appropriate course of action (see paragraph 225.27). The determination of whether to disclose the matter to an appropriate authority will, however, also take into account considerations such as whether or not there is an appropriate authority, whether there exists robust and credible legal protection, and whether there are threats to the physical safety of the auditor or others (see paragraph 225.27).
58. If the auditor were to determine that disclosure to an appropriate authority would be the right course of action in the circumstances even though not required by law or regulation, the Code would allow

them to do so under the general permission granted under Section 140<sup>8</sup> of the Code. Under that Section, PAs have a right to disclose confidential information to comply with ethics standards (see paragraph 140.7(c)(iv) in the list of consequential and conforming amendments). For the avoidance of doubt, the Board proposes that the specific application of this general permission be made clear in paragraph 225.29, i.e., that such disclosure will not be considered a breach of the duty of confidentiality under the Code.

59. The Board heard of many concerns from stakeholders in response to the original ED as well as during the roundtables about the dilemma auditors and other PAs can face in jurisdictions that have strict confidentiality laws if the Code were to lead them to conclude that disclosure to an appropriate authority would be necessary. The Board believes it is important to emphasize that the Code does not override laws and regulations. The Board is therefore proposing that Section 225 make clear that disclosure would be precluded if it would be contrary to laws and regulations (see paragraph 225.27).
60. In the light of the responses to the ED and the Board's further research and consultations with stakeholders, 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. The Board has come to this view for the following reasons:

- Protection is generally linked to a legal or regulatory reporting requirement

The Board believes that it would not be workable for the Code to establish a disclosure *requirement* preconditioned on there being legal protection for the PA. Independent legal advice the Board has received indicates that where protection is available:

- It is generally tied to a pre-existing specific legal or regulatory reporting obligation, with a specific reporting threshold that may not be aligned with that in the Code;
- It is unlikely to be sufficiently broad to cover the scope of NOCLAR envisaged to be addressed by the proposed framework; and
- The nature of the protection is often limited.

In addition, while protection is likely to be provided in relation to discrimination against employees, there may be no protection for firms against actions for breach of confidentiality, negligence or defamation. Further, whether a disclosure requirement in the Code can be effective will depend on the existence of an established, robust and trusted legal process, including one where there is effective enforcement and where protection is afforded for the accused. The Board does not believe that it is practicable to specify these as preconditions in the Code.

- Potentially severe practical consequences

Even if preconditions could be precisely defined for a disclosure requirement in the Code, the Board has come to the view that such a requirement would likely not be operable because of potentially severe practical consequences for PAs and others. In particular, the Code is, or forms a basis for, law or regulation in a number of jurisdictions.<sup>9</sup> In extreme cases, individuals convicted of certain types of NOCLAR can face capital punishment. The Board does not believe that it would be reasonable for compliance with a disclosure requirement in the Code to result

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<sup>8</sup> Section 140, *Confidentiality*

<sup>9</sup> For example, Albania, the Bahamas, Ivory Coast, Jordan, Kenya, Lesotho, Macedonia and Zambia

in such an outcome. In the Board's view, only lawmakers in the particular jurisdictions should determine what they would intend or accept as consequences for a reporting requirement.

- Potential for unintended consequences

The legal advice the Board has received also indicates the potential for significant unintended consequences for the public interest if the Code were to mandate disclosure. In particular, this could adversely impact the relationship between the client and PA, with the PA becoming a quasi-investigator or prosecutor in relation to NOCLAR. A consequence could be an adverse effect on the free flow of information between the client and the PA, which could be damaging to audit quality in particular.

Imposing a disclosure obligation could also have the unintended consequence of discouraging PAs from taking senior roles in business, for instance as CFOs and Finance Directors, given the potential for negligence actions and the fear of being exposed to retaliation. There would also be a real risk that PAs choose not to apply the Code or choose to leave the profession. The Board believes that such potential consequences would not be in the public interest.

*Appropriate Authority*

61. The ED explained that an appropriate authority is "one with responsibility for such a matter." It also stated the following:

In many instances, that authority will have the ability to investigate and take action to safeguard the public interest. The appropriate authority to which to disclose the matter will depend on the nature of the suspected illegal act, for example a competition regulator in the case of a suspected cartel arrangement, and a securities regulator in the case of suspected fraudulent financial reporting in a listed entity.

62. Many respondents noted uncertainty as to who the appropriate authority might be as the term was undefined. It was noted in particular that there could be a wide range of authorities at different levels of government (for example, federal, state and city) in a given jurisdiction.

63. A few respondents commented that the ED did not appear to have taken into account the capacity and effectiveness of the legal system to respond to disclosures of NOCLAR or suspected NOCLAR. Some respondents also noted that not all countries may have an appropriate authority, particularly if reporting is not mandated in law.

64. Recognizing these concerns, the Board proposes that the description of an appropriate authority be more clearly circumscribed to one that is able to receive the information and cause the matter to be investigated and action to be taken (paragraph 225.27). The Board, however, believes that it is important to note that who the appropriate authority will be will depend on the nature of the matter (see paragraph 225.28). It will be necessary for auditors to make the appropriate judgment in the particular circumstances, given the context of the local legal and regulatory framework.

65. The Board does not believe that it is appropriate to place further constraints as to who the appropriate authority might be in terms of the capacity or effectiveness of the authority. It is beyond the remit of the Code to call upon auditors and other PAs to make an assessment of such matters, nor will it be practicable for them to do so.



*Obtaining Legal Advice or Consulting Other Sources*

66. The Board noted strong views from a number of participants at the three roundtables that in practice, the situation may often require complex analysis and judgments. Accordingly, it was felt that the need for legal advice, particularly in relation to possible courses of action, cannot be overemphasized. The Board accepted that this reality should be acknowledged and has therefore proposed guidance to that effect (see paragraph 225.26).

(b) SENIOR PAIBS

*Description of Senior PAIBs*

67. Consistent with the feedback from the roundtables, the Board believes that senior PAIBs should have a greater responsibility to take action in response to identified or suspected NOCLAR than other PAIBs, given their decision-making ability and the expectations of them by virtue of their positions.
68. In this regard, the Board proposes to describe senior PAIBs as follows, leveraging the Board's recently revised guidance on management responsibility (revised paragraph 290.159<sup>10</sup> of the Code):

Senior professional accountants in business are directors, officers or senior employees able to exert significant influence over, and make decisions regarding, the acquisition, deployment and control of the employing organization's human, financial, technological, physical and intangible resources.

*Overarching Expectations for Senior PAIBs*

69. One of the key messages from the roundtables was the need to emphasize the responsibilities of senior PAIBs in setting the right tone at the top and in establishing the appropriate controls within their organizations to prevent or deter NOCLAR. The Board believes that this emphasis should be made in the Code, recognizing that the primary responsibility for ensuring that an entity conducts its business in full compliance with all applicable laws and regulations rests with management.
70. The Board has therefore proposed changes to Section 300<sup>11</sup> of the Code to provide additional guidance in that regard. These changes were merged with other changes arising from the Board's Part C project and are reflected in the following proposed revised paragraph 300.5, which the Board issued for [exposure](#) in November 2014:

A professional accountant in business may hold a senior position within an organization. The more senior the position of the professional accountant, the greater will be the ability and opportunity to influence events, practices policies and attitudes decision-making. A professional accountant in business is expected, therefore, to encourage an ethics-based culture in an employing organization, that emphasizes the importance that To the extent that the professional accountant is in a position to do so, the professional accountant shall take reasonable steps to identify, implement and oversee safeguards in the work environment to encourage or promote an ethics-based culture, including policies and procedures to prevent non-compliance with laws and regulations. Ethics policies and whistleblowing procedures that have been communicated to all employees may be useful to achieve the objective of establishing and maintaining an ethics-based culture. Such policies and procedures help

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<sup>10</sup> Revised paragraph 290.159 states that "[m]anagement responsibilities involve controlling, leading and directing an entity, including making decisions regarding the acquisition, deployment and control of human, financial, technological, physical and intangible resources."

<sup>11</sup> Section 300, *Introduction*

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to encourage ethical behavior and increase the likelihood of senior management places on ethical behavior being alerted to a problem in time to prevent serious harm.

71. The Board believes that these proposed changes will assist in stimulating appropriate behavioral changes among a group of PAs who have the ability to make a difference within their organizations. The Board also believes that this top-down element of the proposed framework has the benefit of bringing greater balance to the revised proposals compared with the original ED, which focused almost entirely on escalating matters up the chain of command for an appropriate response to the issue.

*Required Responses for Senior PAIBs*

72. The Board believes that the response framework for senior PAIBs should be broadly comparable to that for auditors (see Appendix 1) but with the following notable exceptions:
- Senior PAIBs should take appropriate steps to have the consequences of the NOCLAR or suspected NOCLAR rectified, remediated or mitigated, and to reduce the risk of re-occurrence.
  - They should also take appropriate steps to deter the NOCLAR if it has not yet occurred.
  - They should alert the external auditor, if any, pursuant to their duty or legal obligation to provide all information necessary to enable the auditor to fulfill the auditor's responsibilities. (See paragraphs 360.17-18.)

(c) PAS IN PUBLIC PRACTICE PROVIDING SERVICES OTHER THAN AUDITS

73. For these PAs, the Board believes that the extent of the required response should be less compared with that for auditors. This is consistent with the former's generally narrower mandates and the lower level of public reliance on the services they provide.
74. Accordingly, the Board proposes that for these PAs they should only be required to:
- Seek to obtain an understanding of the matter (see paragraph 225.34).
  - Discuss the matter with the appropriate level of management and, if they have access to them and where appropriate, TCWG (see paragraph 225.35). In situations where the client is just an individual, the discussion will by necessity be with only that individual.
  - If the client is also an audit client of the firm, communicate the matter within the firm so as to enable the engagement partner for the audit to be appropriately informed about it and for the latter to determine how it should be addressed in accordance with proposed Section 225 (see paragraph 225.39).
  - If the client is an audit client of a network firm, consider communicating the matter to the network firm so as to enable the engagement partner for the audit to be appropriately informed about it (see paragraph 225.40). (See further discussion below.)
  - Stand back and consider whether further action is needed to achieve the objectives under the proposed Section. Such further action may include disclosing the matter to the external auditor or to an appropriate authority as would be permitted under paragraph 140.7(c)(iv). (See paragraphs 225.41, 43 and 45.)
  - Also stand back and consider if they can remain associated with the client in order to comply with the fundamental principles (see paragraph 225.47).

75. The need for, and the nature and extent of, further action will depend on a number of factors, including the legal and regulatory framework, the response of management and TCWG, the urgency of the matter, and the likelihood of substantial harm to the client or stakeholders (see paragraph 225.42).
76. The Board has been careful not to replicate all the detailed guidance applicable to auditors in the section addressing other PAs in public practice to avoid conveying the impression that the latter have the same level of responsibility to respond to NOCLAR or suspected NOCLAR as the former. These other PAs, however, would not be precluded from considering the guidance applicable to auditors.

*Circumstances Where the Client is an Audit Client of a Network Firm, and Certain Forensic Engagements*

77. The Board noted that there should generally be no impediments to reporting the matter within a firm where the client is also an audit client of the firm (unless there are specific engagement terms precluding such disclosure). The situation may, however, be more complex and nuanced where the client is an audit client of a network firm. In particular, there may be local laws or regulations that prevent disclosure *outside* the jurisdiction. Also, the nature of the engagement itself may limit disclosure outside the firm, such as in the case of certain forensic or litigation services or in an ongoing investigation into the matter by a prosecutor. In addition, materiality may be an important consideration (for example, the matter may be immaterial to the audit of the group). For these reasons, the Board does not believe that it is appropriate to mandate reporting to a network firm without appropriate consideration of the context and circumstances.
78. The Board considered whether to provide guidance on this issue. The Board felt that addressing all the potential complexities of reporting to another network firm would lead to proposed Section 225 becoming unbalanced and skewed towards this particular aspect of the proposals, thus detracting from the broader principles the Board is aiming to establish in the framework. The Board believes that a firm should appropriately judge whether to report to another network firm taking into account the circumstances of the matter and the jurisdictional context. Accordingly, the Board has not proposed detailed guidance on this particular issue.
79. The Board has, however, provided guidance on factors to consider regarding whether information can be disclosed *outside the entity* (see paragraph 225.44). These factors include, in particular, whether the terms or nature of the engagement would preclude disclosure to third parties, such as where legal privilege exists which extends to the PA. The Board believes that articulating this particular factor will help to respond to comments from a number of respondents to the ED, as well as some participants at the roundtables, who were concerned that certain engagements conducted under the expectation of privilege, such as when the PA is engaged by a law firm to undertake a forensic engagement, would be scoped in under the proposals. For the avoidance of doubt, the Board does not intend such engagements to be covered by the proposals insofar as disclosure outside the entity is concerned.
80. Other engagements, including forensic-type engagements, where legal privilege does not apply are covered by the proposals. However, as noted in paragraph 73 above, the extent of the PA's required response in those circumstances would be less compared with that for auditors.

*Review and Other Assurance Engagements*

81. Pursuant to a matter raised during consultation with the IESBA CAG, the Board considered whether the approach to responding to NOCLAR or suspected NOCLAR for PAs in public practice should be distinguished between assurance engagements more broadly (including audit and review engagements) and non-assurance engagements, rather than between audits and other services. It

was noted at the CAG in particular that PAs performing review engagements generally have the same access to TCWG as those performing audit engagements.

82. The Board does not believe that making the split between assurance and non-assurance engagements for the proposed framework is appropriate. This is because the provision of review and other assurance engagements other than audits of financial statements varies significantly around the world, as does the level of public reliance on them. Also, audits tend to be significantly more legislated or regulated than other assurance engagements.
83. Jurisdictions would not be precluded from extending the proposed framework to cover specific types of assurance engagement other than audits should they believe that doing so would be appropriate for their national contexts.

(d) OTHER PAIBS

84. For these PAs, the Board believes that the extent of the required response should be less compared with that for senior PAIBs, consistent with their more limited spheres of influence. Accordingly, the Board proposes that for these other PAIBs, they should only be required to:
  - Seek to obtain an understanding of the matter (see paragraph 360.31); and
  - Escalate the matter to an immediate superior or the next higher level of authority within the organization (see paragraph 360.33), or use the established internal whistle-blowing procedure if available (see paragraph 360.11).
85. The Board does not believe it necessary to distinguish between different levels of seniority for these PAIBs given that the responsibilities flow through up the chain of command.
86. Nothing under the proposed framework would preclude PAIBs who are not senior PAIBs from deciding to disclose the matter to an appropriate authority. To make this clear, the Board has proposed guidance in paragraph 360.34.

**D. Documentation**

87. The ED proposed to require PAs in public practice and PAIBs to document, among other matters, the steps taken to respond to a suspected NOCLAR, including the persons consulted, responses received, and the disclosure, if any, made to an appropriate authority.
88. Views on this proposal were divided. Many respondents were supportive of the requirements as proposed, with a few requesting further guidance to facilitate proportionate application and to avoid PAs inadvertently prejudicing the legal process.
89. Many others, however, disagreed. Among the concerns expressed were that:
  - The requirements would be disproportionate as they seemed to call for documentation regardless of whether the suspected NOCLAR was of any consequence; and
  - The resulting documentation may be legally discoverable.
90. Several others were of the view that the proposal seemed to move the Code away from its current position of generally advocating documentation in the PA's interests but not requiring it. A few others felt that the ED went too far in proposing a documentation requirement for PAIBs and that any such requirement should be limited to PAs performing audit engagements. Even then, however, a view was expressed that documentation requirements are adequately addressed elsewhere in professional standards.

91. In the light of these concerns, the Board has reconsidered the approach to documentation. The Board noted that auditors are already required under the ISAs to prepare audit documentation, including documentation of identified or suspected NOCLAR. The Board proposes that auditors be reminded of their obligations in this respect (see paragraph 225.31). In addition, in response to stakeholder feedback during the development of the framework, the Board proposes that the Code require auditors to document, with respect to identified or suspected NOCLAR that they have concluded is a *significant matter*.
- How management and, where applicable, TCWG have responded to the matter.
  - The courses of action the auditors considered, the judgments they made and the decisions they took, having regard to the reasonable and informed third party test.
  - How they are satisfied that the objectives under the proposed Section 225 have been met. (See paragraph 225.32.)
92. The Board believes that this documentation requirement for auditors is appropriate given the higher public expectations of their role. Such documentation would cover the specific considerations, judgments and decisions that would be called for under the proposed framework. This documentation requirement, which is an integral part of the framework, is intended to serve the purposes of the Code. It is not intended to modify or detract from the documentation requirements in the ISAs.
93. For other PAs, including PAIBs, the Board proposes that the documentation approach only differ in terms of the level of obligation imposed, i.e., no requirement but an encouragement (see paragraphs 225.48 and 360.35).
94. The Board believes that these revised documentation proposals are responsive to the feedback received from stakeholders on the ED and during the consultation process in the development of the proposed framework. They are also proportionate and give due regard to avoiding excessive documentation that would otherwise place an unreasonable burden on PAs.

**E. Communication Between Successor and Predecessor Auditors**

95. Section 210 of the Code currently suggests as a safeguard that when considering taking up a new appointment with a prospective client, a PA in public practice ask the existing PA to provide known information on any facts or circumstances that, in the latter's opinion, the former needs to be aware of before deciding whether to accept the engagement.<sup>12</sup>
96. In developing the proposed framework, the Board noted the importance of communication between successor and predecessor auditors in the case of audits of financial statements. The Board acknowledged that it would not be in the public interest if a case of serious NOCLAR or suspected NOCLAR were to be simply "dropped" because of the withdrawal of the existing auditor without a potential successor being alerted to it. Some on the IESBA CAG had also flagged this issue for further consideration. In addition, a regulatory respondent to the ED had recommended that the Board consider requiring the predecessor auditor to notify a successor auditor of the matter so that the latter understands the risk of accepting the engagement.
97. The Board recognized the potential benefits through mandating this communication in the Code. In particular, this could more effectively lead to desired outcomes in the public interest in terms of stimulating appropriate actions by management or TCWG to respond to the NOCLAR or suspected

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<sup>12</sup> Section 210, *Professional Appointment*, paragraph 11

NOCLAR. Importantly, knowledge that such a communication requirement exists could have the effect of ensuring that management and TCWG respond appropriately. The Board also considered existing practice in Canada and the UK where the national ethics requirements already mandate such a communication.

98. The Board therefore proposes that Section 210 be amended as follows:

- Requiring in the case of an audit of financial statements that a proposed auditor request the existing auditor to provide known information regarding any facts or circumstances that, in the latter's opinion, the former needs to be aware of before deciding whether to accept the engagement (see paragraph 210.13 in the list of consequential and conforming amendments).
- Requiring the existing auditor to provide the information honestly and unambiguously, subject to client consent regarding the disclosure (paragraph 210.13).
- If the client fails or refuses to grant consent, requiring the existing auditor to disclose this fact to the proposed auditor, and requiring the latter to then carefully consider such failure or refusal when determining whether or not to accept the appointment (paragraph 210.13).
- Making a conforming deletion of the guidance in paragraph 210.9 which currently indicates that depending on the nature of the engagement, direct communication with the existing PA may be required to establish the facts and circumstances regarding the proposed change.

99. The Board proposes that the communication requirement apply only in the case of audits of financial statements given the greater public interest role of auditors. Therefore, in all other cases, communication by a proposed PA with an existing PA will continue to be a possible safeguard (see paragraph 210.9).

100. This proposal is also responsive to a recommendation that arose from the IAASB's Audit Quality project for the IESBA to consider improving information sharing between audit firms when one firm decides to resign from, or is not reappointed to, an audit engagement. Further, the proposal would complement the ISAs given that ISA 300 already requires a successor auditor to communicate with a predecessor auditor in compliance with relevant ethical requirements.<sup>13</sup>

#### IV. Strengths of the Proposed Framework

101. This section outlines the strengths of the proposed framework and why the Board believes it will better lead to the desired outcomes in the public interest.

##### *A Holistic and Balanced Model*

102. Through establishing overarching objectives, the proposed framework represents a holistic, balanced and principles-based approach to guiding PAs in responding to NOCLAR or suspected NOCLAR. It focuses on the desired *outcomes* in the public interest, i.e., that:

- (a) PAs comply with the fundamental principles of integrity and professional behavior, and therefore do not turn a blind eye to an instance of NOCLAR or suspected NOCLAR;
- (b) By bringing the matter to the attention of management and, where appropriate, TCWG, PAs seek to enable them to rectify, remediate or mitigate the consequences of the identified or suspected NOCLAR, or to deter the commission of the NOCLAR; and

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<sup>13</sup> ISA 300, *Planning an Audit of Financial Statements*, paragraph 13

(c) PAs take further action as may be needed in the public interest.

103. The proposed framework also recognizes the roles and capacities of the relevant parties in addressing the matter. It places appropriate and necessary emphasis on the actions of auditors and other PAs vis-à-vis the responsibilities of management and TCWG. It therefore encourages measures to prevent, detect and appropriately respond to NOCLAR by the client or the employing organization itself. It also specifies essential principles for PAIBs given that they play an important role as a “first line of defense” against NOCLAR.
104. Further, it is responsive to the feedback received from stakeholders on the original ED and at the roundtables in terms of balancing in a robust way the need for PAs to act in the public interest against considerations of global operability.

*Clear Scoping and Threshold for Further Action*

105. The proposed framework sets out a clear and simple scope for the types of laws and regulations that are addressed. In addition, it specifies a clear threshold for further action in terms of “substantial harm” to stakeholders, thereby facilitating more consistent application.

*A Proportionate Approach*

106. The proposed framework sets out a proportionate approach for responding to NOCLAR or suspected NOCLAR for the different categories of PAs, recognizing their different spheres of influence and what they are able to do in their different capacities. In particular, it distinguishes auditors from PAs in public practice providing non-audit services, and scales the responsibilities accordingly, recognizing the higher public expectations for the former. It does the same for senior PAIBs relative to other PAIBs, recognizing the fiduciary nature of the roles and the levels of influence and decision-making of the former within the employing organization.

*A Renewed Emphasis on the Tone at the Top within the Employing Organization*

107. Through proposed changes to Section 300 of Part C of the Code,<sup>14</sup> the proposed framework re-emphasizes the importance of the tone at the top, particularly with respect to the promotion of a culture of compliance with laws and regulations and prevention of NOCLAR within the employing organization. This includes, to the extent the PAIB is in a position to do so, taking reasonable steps to establish policies and procedures to that effect.

*Stimulating Increased Reporting Under Law or Regulation*

108. Anecdotal evidence in some jurisdictions suggests that even where reporting requirements exist under law or regulation, PAs are not reporting instances of NOCLAR or suspected NOCLAR to appropriate authorities. For example, available data for 2009 indicate that the number of reports that PAs filed with authorities in EU member states under the EU’s Third Money Laundering Directive varied significantly,<sup>15</sup> notwithstanding that member states have some leeway in how they implement the Directive at the national level.

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<sup>14</sup> The proposed changes have been issued for comment as part of the Part C Phase I [exposure draft](#).

<sup>15</sup> The available statistics for the number of suspicious activity reports filed by PAs in 2009 under the Third Money Laundering Directive include, for example, UK: over 6300 PAs; Germany: 1 auditor and 3 other PAs; France: 22 auditors and 55 other PAs; Bulgaria, Latvia, Lithuania, Poland and Slovenia: 0.

109. The proposed framework aims to support and enhance compliance by PAs with existing legal or regulatory reporting requirements, and thus stimulate a greater incidence of actual reporting. It does so by requiring all categories of PAs to *understand* what those provisions are when they face identified or suspected NOCLAR, and not merely to comply with them. In this way, the Code would support existing laws and regulations governing the reporting of NOCLAR or suspected NOCLAR by PAs to achieve the desired outcome of increasing reporting of such matters to appropriate authorities.
110. Additionally, in jurisdictions where there is little or no guidance as to how to implement a legal or regulatory requirement to report NOCLAR or suspected NOCLAR to appropriate authorities, the proposed framework will support and complement the legal and regulatory framework by providing the necessary guidance.
111. The Board notes that many jurisdictions, including most in the G-20, have established requirements in law or regulation for auditors in particular to report NOCLAR or suspected NOCLAR to appropriate authorities.<sup>16</sup> Many jurisdictions<sup>17</sup> also have signed up to the Financial Action Task Force (FATF) recommendations on anti-money laundering.<sup>18</sup>

*An Expanded Auditors' "Toolkit"*

112. For auditors, the proposed framework would expand their "toolkit" for dealing with NOCLAR or suspected NOCLAR. It would in particular provide a pathway to disclosure of a serious NOCLAR or suspected NOCLAR to an appropriate authority without the duty of confidentiality under the Code standing in the way.
113. It would also require communication between a proposed auditor and an existing auditor regarding reasons when there is a change in appointment. In addition to having the effect of ensuring that management and TCWG respond appropriately, this measure would increase the likelihood that serious issues of NOCLAR are appropriately flagged to and addressed by successor auditors.
114. These additional tools would supplement the options auditors have of disclosure of the matter in, or modification of, the auditor's report and the threat of withdrawal from the audit engagement and client relationship.

*A Rigorous Consideration of Further Action Needed in the Public Interest, and Documentation*

115. For auditors and senior PAIBs, the proposed framework would require them to consider such further action as may be needed in the public interest. Through mandating application of a third party test, it would require them to objectively assess the facts and circumstances at the time to determine the need for, and nature and extent of, such further action.

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<sup>16</sup> See the [Appendix](#) to the January 2015 IESBA issues paper.

<sup>17</sup> Over 180 jurisdictions around the world have committed to the FATF recommendations: <http://www.fatf-gafi.org/countries/>. The FATF recommendations can be accessed at: [http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF\\_Recommendations.pdf](http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf).

<sup>18</sup> Under FATF Recommendation 23 for Designated Non-Financial Businesses and Professions (DNFBPs), accountants are required to report suspicious transactions to appropriate authorities when, on behalf of or for a client, they engage in a financial transaction in relation to the following activities: buying and selling of real estate; managing of client money, securities or other assets; management of bank, savings or securities accounts; organization of contributions for the creation, operation or management of companies; creation, operation or management of legal persons or arrangements, and buying and selling of business entities. In addition, countries are strongly encouraged to extend the reporting requirement to the rest of the professional activities of accountants, including auditing.



116. In relation to auditors where the identified or suspected NOCLAR is considered to be a significant matter, it would require documentation of how management and, where applicable, TCWG have responded to the matter, the courses of action considered, judgments made and decisions taken, and how the auditors are satisfied that the objectives have been met.
117. At the same time, the proposed framework would address PAs' need for guidance in dealing with what will, as noted above, often be difficult and stressful situations when they have identified or suspect NOCLAR, consistent with the original objective of the project. There is less prescription in the escalation process, recognizing the need for judgment and the fact that in practice the situation may be complex and fluid, and often may require legal interpretation.

## V. **Broader Considerations**

118. The Board recognizes that the Code operates as part of a wider framework, which needs to include strong corporate governance systems and robust, trusted and effective legal and regulatory regimes. The Board believes that all the elements of the wider framework are important in ensuring that the issue of NOCLAR is addressed holistically.
119. PAs must do their part in responding to NOCLAR or suspected NOCLAR within the context of their responsibility to act in the public interest, alongside other stakeholders. In particular:
- Management and TCWG have fiduciary and other legal and professional responsibilities in addressing issues of NOCLAR.
  - Governments, legislators and regulators are uniquely placed to introduce or strengthen legislation or regulation governing the reporting of NOCLAR, appropriately tailored to their national circumstances. They are also able to enforce such legislation or regulation, and appropriately act on reports of NOCLAR or suspected NOCLAR.
  - Other stakeholders such as regional and international organizations with an interest or a role in ensuring that issues of NOCLAR are appropriately or better addressed can stimulate dialogue, coordination and progress on the topic. Such organizations include international regulators and other policy-making bodies. In this regard, the Board notes the success of organizations such as the Organization for Economic Cooperation and Development (OECD) in leading international efforts to tackle issues such as money laundering and bribery. In addition, the Board notes the recent efforts of the G20 in developing its Anti-Corruption Action Plan, including identifying protection of whistle-blowers as one of the high priority areas in the global anti-corruption agenda.
120. The Board agrees with observations made during its consultations with the IESBA CAG that there is a broader mindset and educational objective that needs to be addressed with PAs in dealing with NOCLAR. The Board is committed to working with legislators, regulators, firms, IFAC member bodies and other stakeholders to ensure that PAs are better aware of and understand their legal and regulatory responsibilities regarding responding to matters of NOCLAR. Effectively addressing this mindset and educational objective may contribute to a significantly improved outcome in terms of increased reporting by PAs of NOCLAR or suspected NOCLAR to appropriate authorities.

## VI. **Liaison with IAASB**

121. Nothing in the proposals is intended to modify or interpret the ISAs. The proposals are intended instead to complement the ISAs, recognizing the different objectives of the Code and the ISAs.

122. The main areas where the proposals expand the obligations of auditors from an *ethical* perspective, as distinct from the requirements on them as specified in ISA 250 when conducting an audit in accordance with ISAs, are in relation to:
- Evaluation of the implications of the matter to stakeholders in financial or *non-financial* terms, and not only with respect to whether there may be material misstatement of the entity's financial statements.
  - A threshold of "substantial harm" as opposed to "material effect on the financial statements" in determining the need for and nature and extent of further action.
  - Consideration of not only NOCLAR that has occurred but also NOCLAR that may occur.
  - A requirement for the auditor to prompt management and, where appropriate, TCWG to address the consequences, deter the NOCLAR, or report it to an appropriate authority.
  - Requirements to understand and comply with applicable laws and regulations and professional standards.
  - A requirement to determine such further action as may be needed in the public interest.
123. The Board has engaged with the IAASB with a view to identifying the implications of the proposals in relation to ISA 250 or other IAASB standards. The IAASB has established a working group to further facilitate this exercise, with a member of the IESBA NOCLAR Task Force participating in the working group.
124. An initial [comparative analysis](#) of the proposals against ISA 250 has been provided to the IAASB working group for further consideration. At its [March 2015 meeting](#), the IAASB considered the process and timeframe for developing any related proposals to address consequential changes to its standards. The Board will further engage with the IAASB as this project progresses.

## VII. Analysis of the Overall Impact of the Proposals

125. Throughout its deliberation of the complex issues in this project, the Board has kept in mind the two key elements in the overall objective of the project, i.e.:
- (a) To enable PAs to decide how best to act *in the public interest* when they come across an act or suspected act of NOCLAR; and
  - (b) To provide them with a framework to *guide* them in doing so.
126. At the same time, the Board has kept in mind concerns raised by stakeholders in response to the original ED and during the roundtables about making sure that the provisions are balanced, practicable and operable on the global basis. The Board firmly believes that the proposals in this re-ED reflect these important considerations, have been appropriately informed by the Board's extensive outreach and consultations with stakeholders since the comment period on the original ED closed, and are in the public interest.
127. The main benefits of the proposed framework have been outlined in Section IV above. In particular, the framework will:
- Support the achievement of the desired outcomes in the public interest in terms of (a) ensuring that PAs respond appropriately to the matter, and (b) encouraging measures to rectify, remediate or mitigate the consequences of identified or suspected NOCLAR, or to deter the commission of NOCLAR.

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- Heighten awareness of the importance of the tone at the top within an organization, particularly with respect to the promotion of a culture of compliance with laws and regulations and prevention of NOCLAR within the organization; and encourage the establishment of appropriate policies and procedures to that effect.
- By specifying ethical standards for PAIBs (and particularly *senior PAIBs*), who represent the first line of defense against NOCLAR, help ensure that NOCLAR issues and their consequences are appropriately addressed and that such issues do not recur.
- Enhance compliance in jurisdictions where law or regulation mandates reporting by PAs of NOCLAR or suspected NOCLAR to appropriate authorities.
- Support implementation of a legal or regulatory reporting requirement where little or no guidance has been provided in the particular jurisdiction.
- Where reporting has not been stipulated under the legal and regulatory framework, provide a pathway to disclosure of identified or suspected NOCLAR to a regulator or other relevant authority in the appropriate circumstances.
- Strengthen auditors' toolkit for dealing with NOCLAR issues in the ways outlined in Section IV above.
- By providing supportive guidance, assist PAs in dealing with NOCLAR situations that can be especially challenging.

128. Considerations relative to costs are set out below for each of the four categories of PA.

### **PAs in Public Practice Performing Audits of Financial Statements**

129. For auditors, the Board considers there will be no incremental costs vis-à-vis what ISAs already require with respect to the audit of the financial statements. Under the ISAs, auditors' work effort will encompass obtaining an understanding of the matter where it has occurred, raising it with management and, where appropriate, TCWG, evaluating its implications for the financial statements, and documenting the relevant discussions, judgments made and decisions taken.
130. There will, however, be incremental costs, including costs associated with obtaining advice from legal counsel or other relevant parties if that were deemed appropriate, in relation to the following areas or circumstances:
- Where NOCLAR or suspected NOCLAR has occurred and the potential consequences of the matter extend beyond a material effect on the financial statements, there will be an element of work effort in evaluating these consequences, including whether there is credible evidence of substantial harm to the entity or stakeholders in financial or non-financial terms.
  - Where NOCLAR *may occur*, the work effort will need to encompass obtaining an understanding of the matter and evaluating its potential implications, raising it with management/TCWG, and assessing their response.
  - There will be incremental costs in following up on the response of management/TCWG, and prompting them to take appropriate action to address the matter if they have not already done so.

## EXPLANATORY MEMORANDUM

- If management/TCWG have not appropriately responded to the matter, there will be incremental costs in determining the need for, and nature and extent of, further action, including exploring possible courses of action and the implications for taking any of them.
- There will be incremental costs in taking the further action(s) if such action(s) were determined to be necessary to meet the objectives under the proposed Section.
- Where the NOCLAR or suspected NOCLAR is considered to be a significant matter, there will be incremental costs in documenting how management and, where applicable, TCWG have responded to the matter, the courses of action considered, judgments made and decisions taken, and how the auditor is satisfied that the objectives under the proposed Section have been met.

### **Senior PAIBs**

131. Senior PAIBs may already have responsibilities in some organizations for promoting an ethics-based culture, including designing and implementing policies and procedures addressing the prevention and detection of NOCLAR, and monitoring the implementation of such policies and procedures. Part of their responsibilities may also involve taking appropriate action to respond to identified or suspected NOCLAR.
132. To the extent that these responsibilities are not already part of senior PAIBs' remit within their organizations, there will be incremental costs in terms of the work effort in complying with the proposed provisions. This includes action to obtain an understanding of the matter, raising it with TCWG, addressing its consequences or deterring the commission of the NOCLAR, determining the need for further action, assessing possible courses of further action, and taking the further action if determined necessary to meet the objectives under the proposed Section 360.
133. While there will be a time cost to addressing the matter from the senior PAIB's perspective, other costs, including costs of any independent investigation or legal advice, will likely be borne by the senior PAIB's organization.

### **PAAs in Public Practice Providing Services Other Than Audits of Financial Statements**

134. The Board considers that there will be costs in seeking to obtain an understanding of the matter and raising it with management/TCWG. There will also be costs, mainly time costs, in communicating the matter within the firm where the client is an audit client of the firm.
135. Where the client is an audit client of a network firm, there may be costs, also mainly of a time nature, in communicating the matter to the network firm where the PA considers that it would be appropriate to do so.
136. There may be additional costs in considering the need and options for further action, and in taking such further action if the PA were to decide that doing so would be appropriate in the circumstances.

### **PAIBs Other Than Senior PAIBs**

137. The Board considers that the costs for these PAIBs will be limited to their efforts in seeking to obtain an understanding of the matter and raising it with their superiors or through their organizations' internal ethics protocols and procedures.
138. Overall, the Board believes that the benefits of the proposals to the public interest would outweigh the costs of implementing them for each of the four categories of PA.

## VIII. Project Timetable and Effective Date

139. The Board is currently undertaking another project to develop a new and improved structure for the Code that will make it easier to use and adopt (Structure of the Code project).<sup>19</sup> As the Board has not yet finalized this new structure and the related new drafting conventions, the Board is issuing the revised NOCLAR proposals for re-exposure under the extant drafting conventions.
140. The Board intends to finalize the NOCLAR proposals under the extant drafting conventions (“close-off” document) by the first half of 2016. The Board will then restructure the close-off document in accordance with the new structure and drafting conventions for the Code and issue the restructured document as an exposure draft for comment on the restructuring only. The exposure draft of the restructured document will include, inter alia, the close-off document and a basis for conclusions explaining how the Board reached its final decisions in closing off the NOCLAR proposals. The Board will communicate in due course the expected timing of issuance of the final restructured pronouncement and its effective date.

## IX. Guide for Respondents

141. The Board has carefully considered the responses to the August 2012 ED, which have resulted in many substantive changes to the original proposals. The Board therefore welcomes comments on all matters addressed in this re-ED, but especially those identified in the Request for Specific Comments below.
142. Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and, where appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in this re-ED, it will be helpful for the Board to be made aware of this view.

### Request for Specific Comments

143. The Board welcomes views from respondents on the following matters.

#### *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?
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?
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;
  - (b) Other PAs in public practice and their clients; and
  - (c) PAIBs and their employing organizations.

<sup>19</sup> See November 2014 Consultation Paper, [Improving the Structure of the Code of Ethics for Professional Accountants](#).

*Specific Matters*

4. Do respondents agree with the proposed objectives for all categories of PAs?
5. Do respondents agree with the scope of laws and regulations covered by the proposed Sections 225 and 360?
6. Do respondents agree with the differential approach among the four categories of PAs regarding responding to identified or suspected NOCLAR?
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?
  - (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?
  - (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?
  - (d) Do respondents support the list of factors to consider in determining whether to disclose the matter to an appropriate authority?
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?
9. Do respondents agree with the approach to documentation with respect to the four categories of PAs?

**Request for General Comments**

144. In addition to the request for specific comments above, the Board is also seeking comments on the matters set out below:
  - (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.
  - (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.
  - (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.

## NOCLAR—Proposed Response Framework

### Objectives – All Categories of Professional Accountants (PAs)

In acting in the public interest:

- To comply with fundamental principles of integrity and professional behavior
- By alerting management or, where appropriate, TCWG, to seek to:
  - Enable them to rectify, remediate or mitigate the consequences of identified or suspected NOCLAR
  - Deter the commission of NOCLAR where it has not yet occurred
- To take such further action as may be needed in the public interest

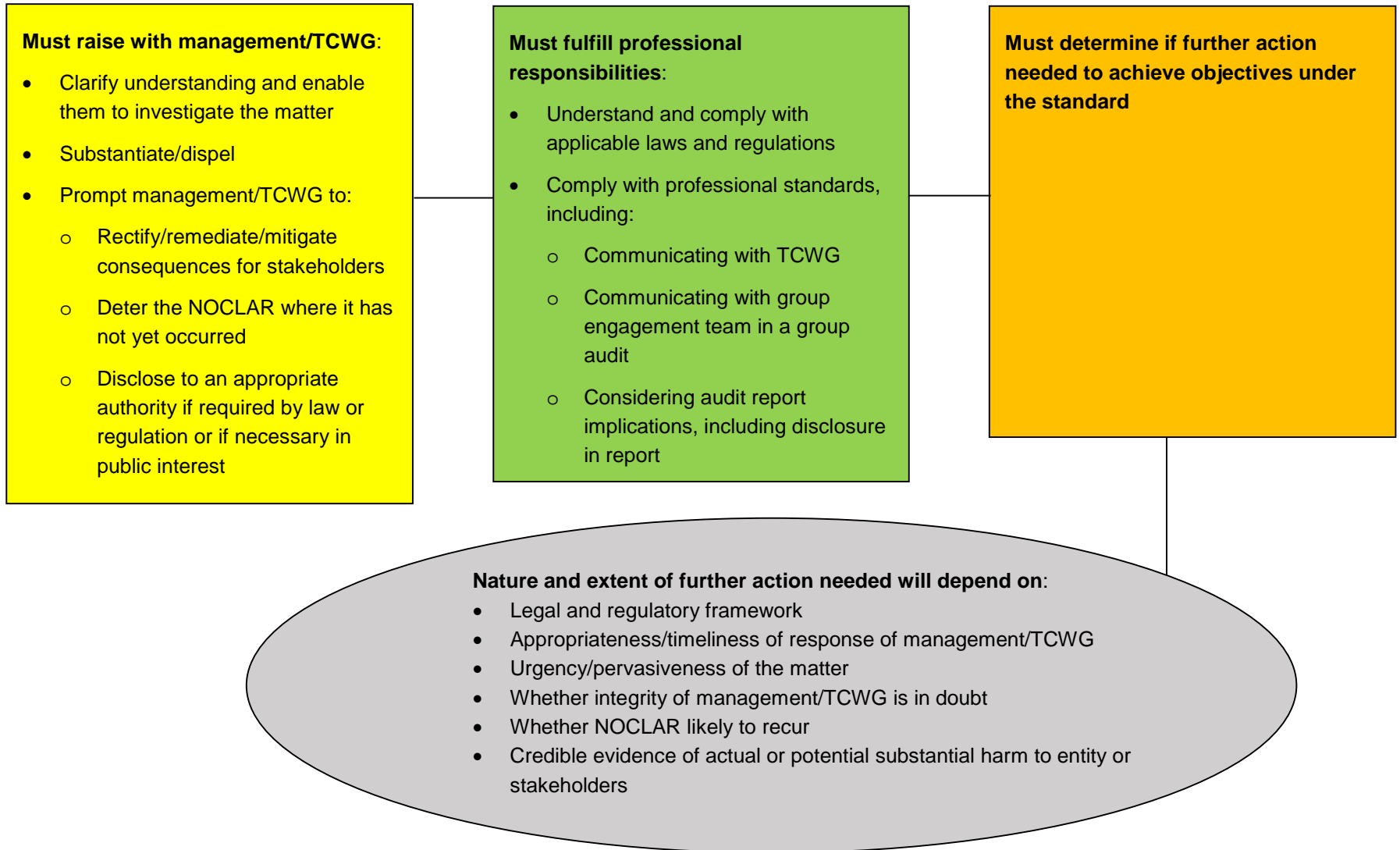
### Scope – All PAs

- Laws and regulations to which ISA 250 applies:<sup>20</sup>
  - Laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements
  - 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 the entity's ability to continue its business, or to avoid material penalties
- No distinction between PIEs and non-PIEs

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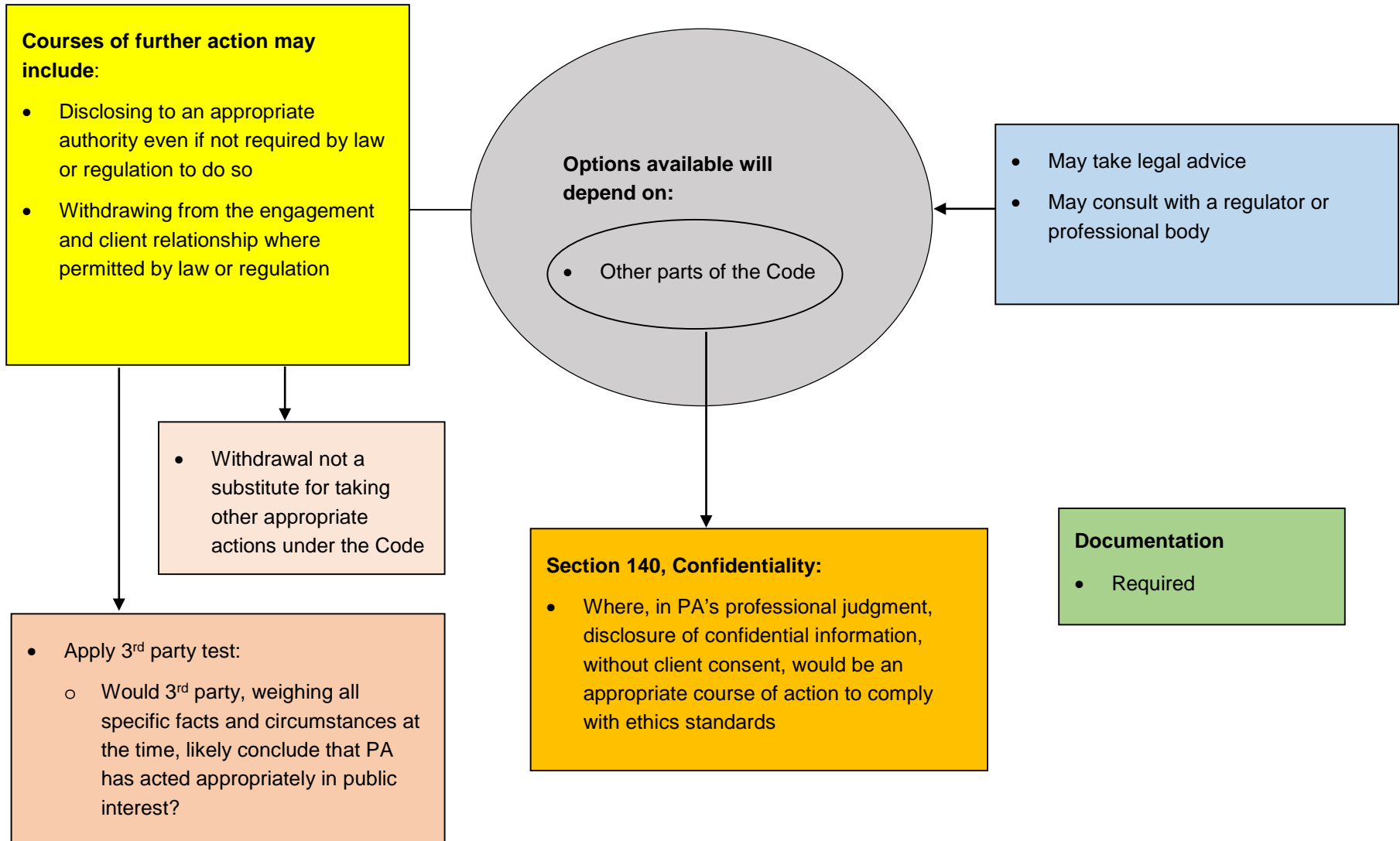
<sup>20</sup> ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*

**AUDITORS – RESPONSE FRAMEWORK WHEN COMING ACROSS IDENTIFIED OR SUSPECTED NOCLAR**

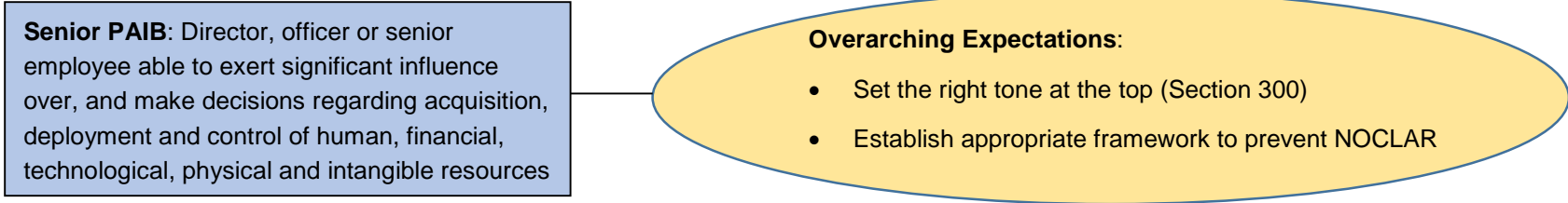




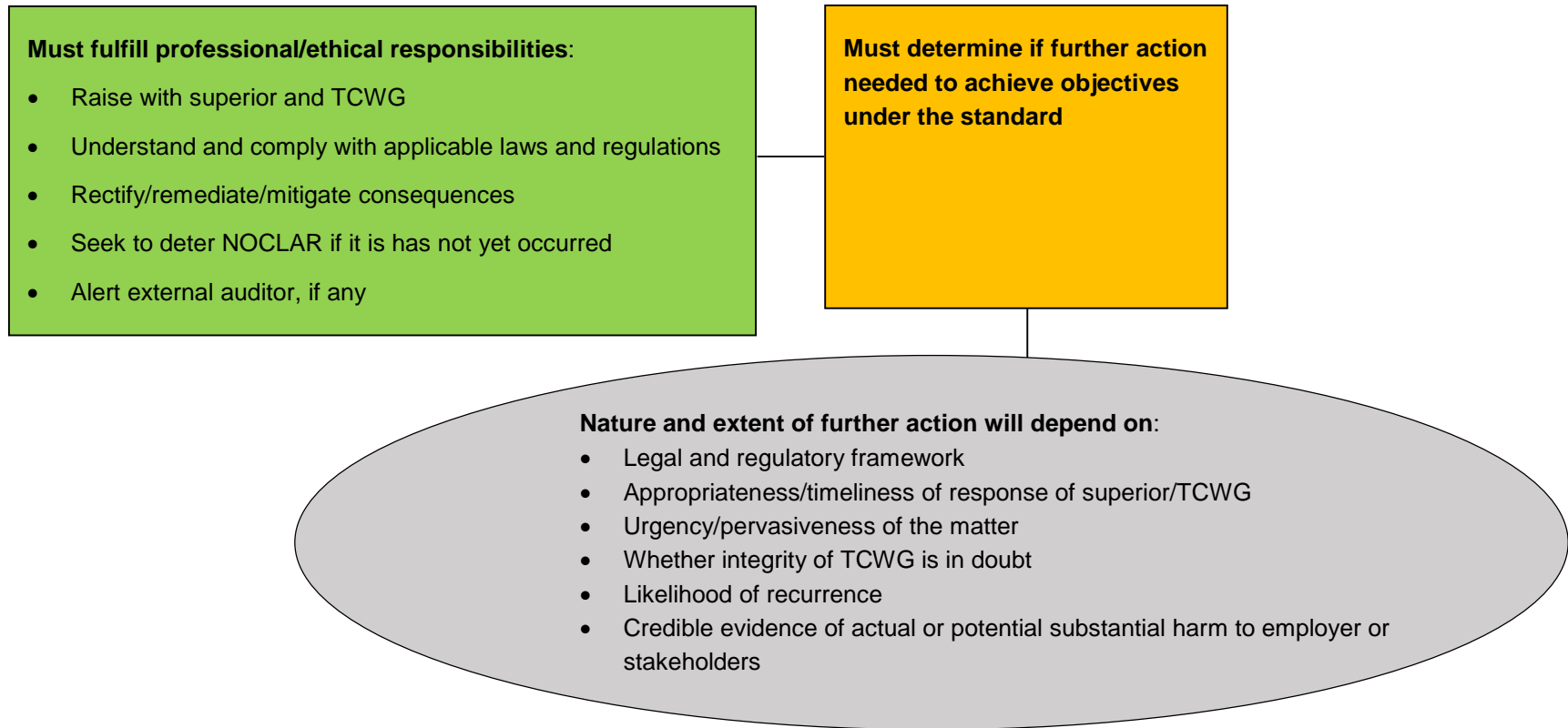
**AUDITORS – DETERMINATION OF FURTHER ACTION NEEDED**



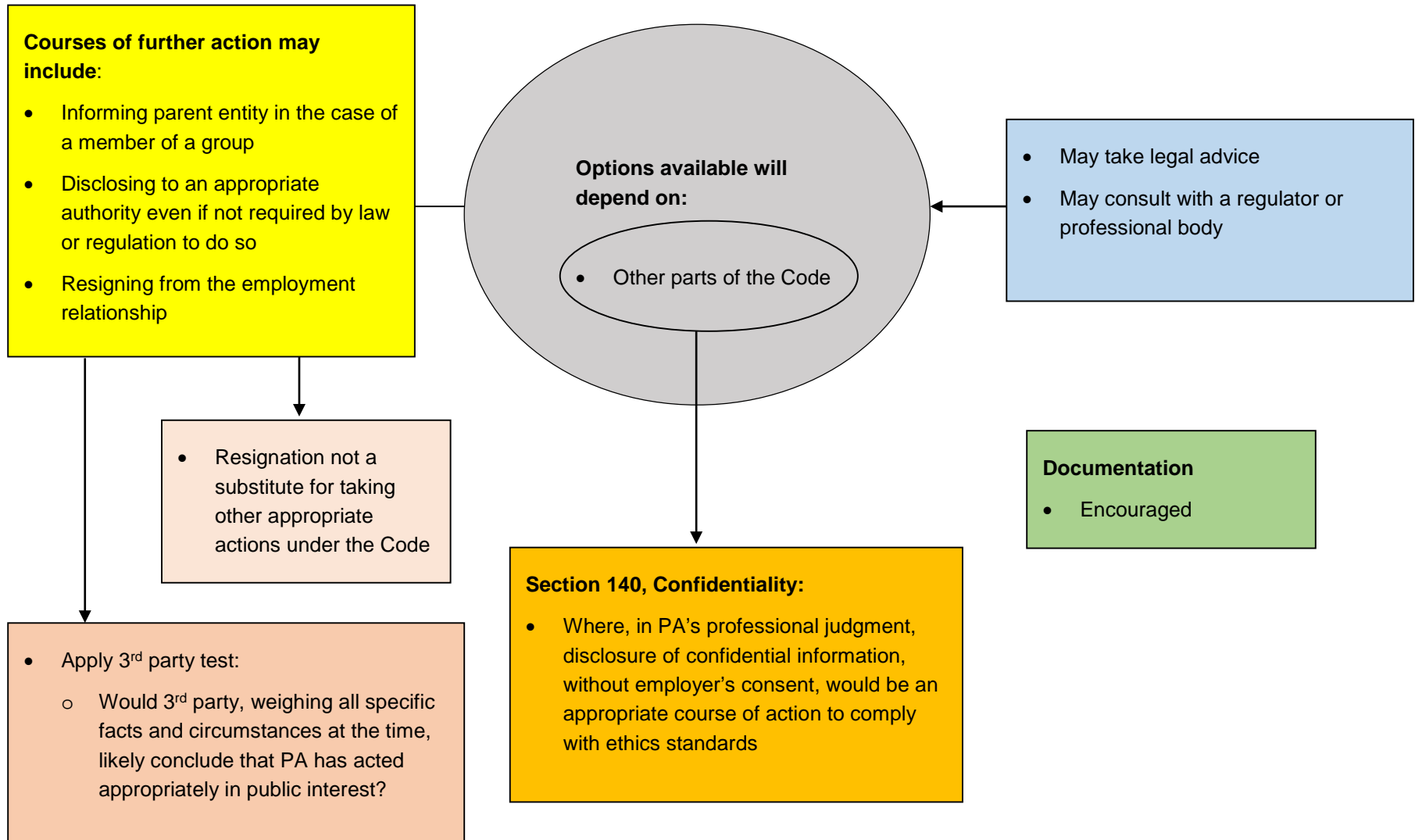
**SENIOR PAIBs**



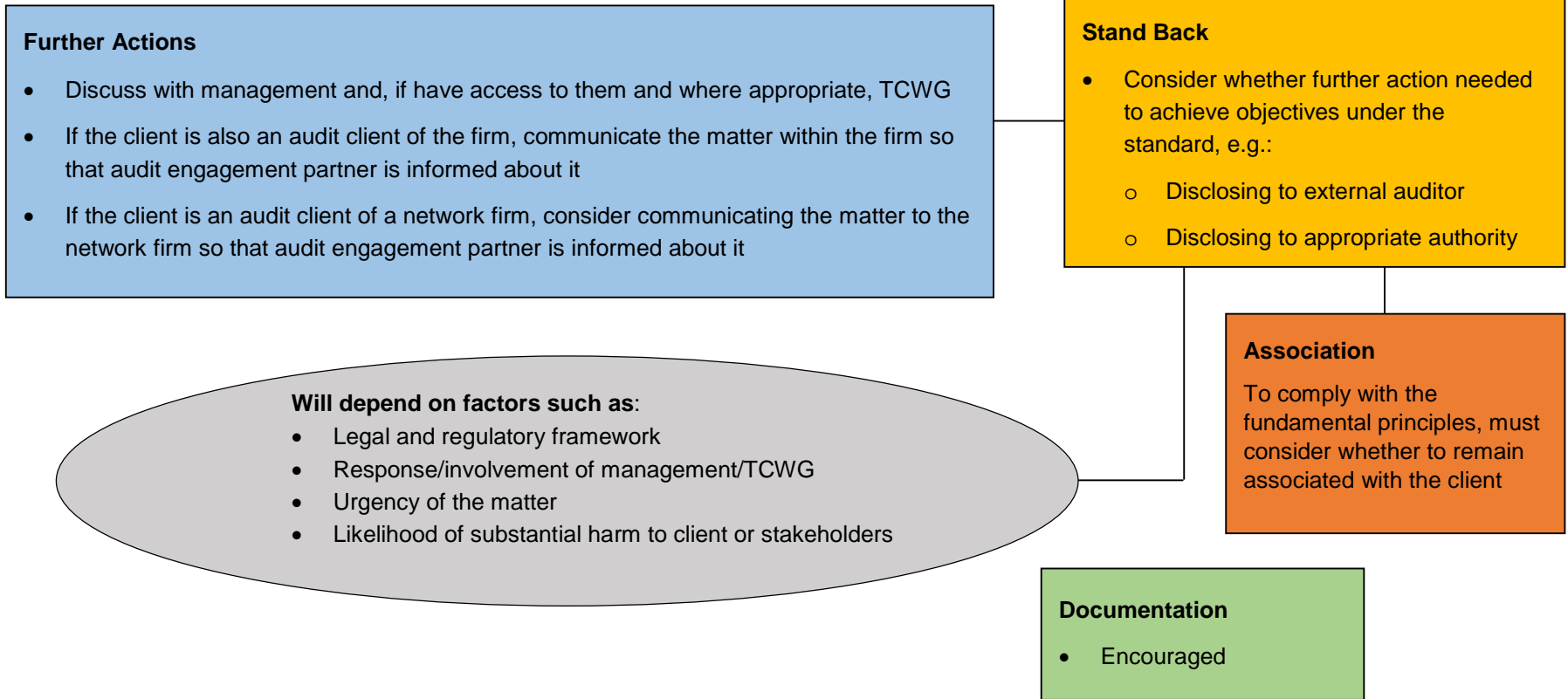
**RESPONSE FRAMEWORK WHEN COMING ACROSS IDENTIFIED OR SUSPECTED NOCLAR**



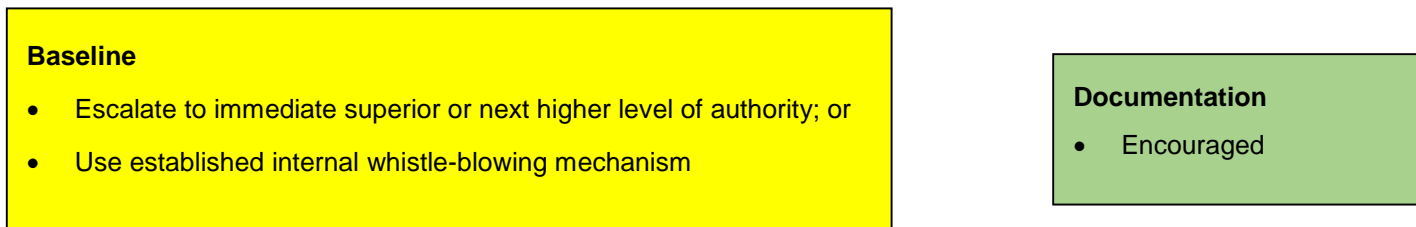
**SENIOR PAIBs – DETERMINATION OF FURTHER ACTION NEEDED**



**PAAs IN PUBLIC PRACTICE PROVIDING SERVICES OTHER THAN AUDITS – RESPONSE FRAMEWORK**



**PAIBs OTHER THAN SENIOR PAIBs – RESPONSE FRAMEWORK**

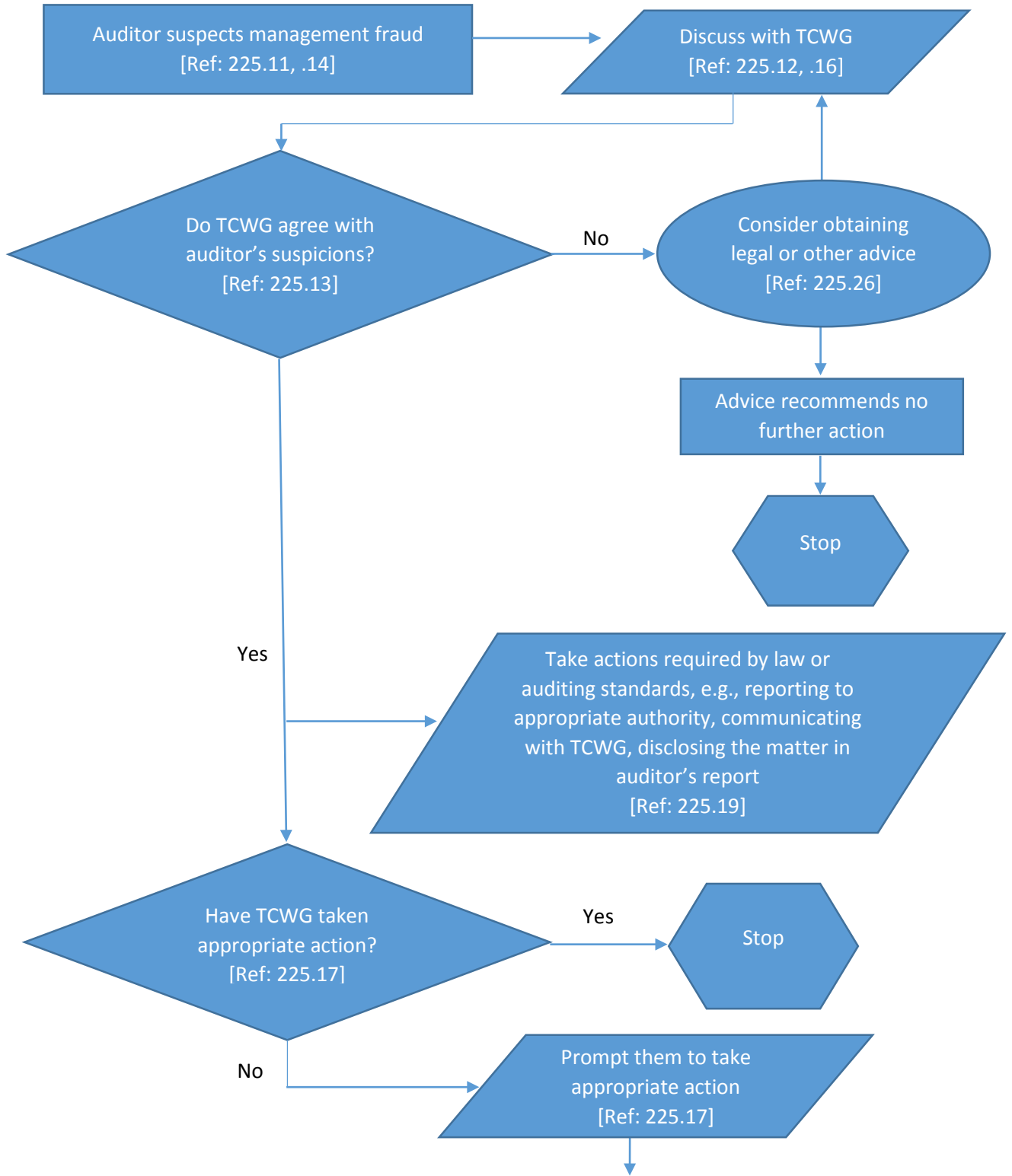


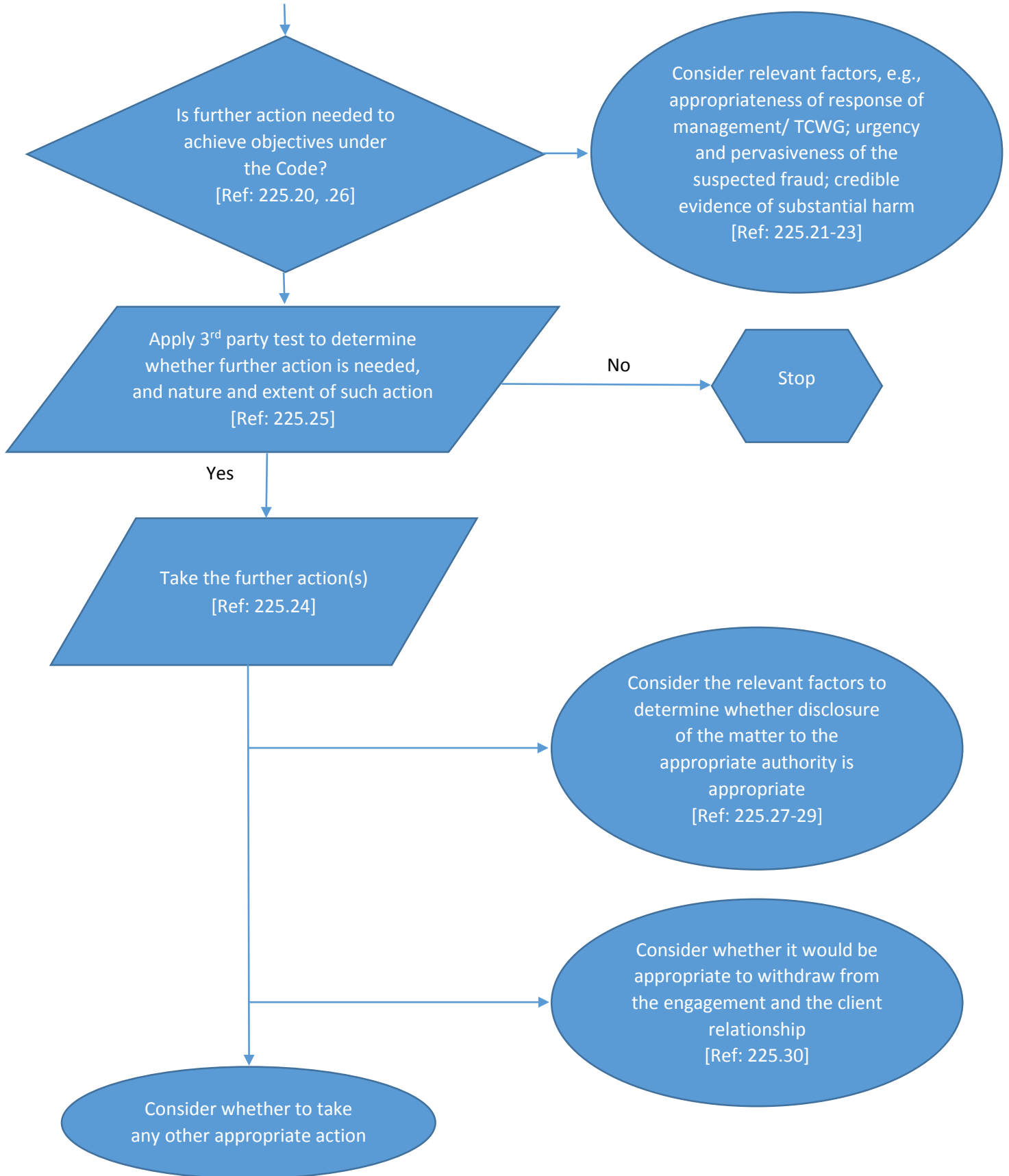
## Illustrative Application of Proposed Framework

### Note

- The following flow chart is only intended to visually illustrate the decision-making process in the case of auditors when applying the proposed framework to respond to a suspected NOCLAR.
- The flow chart does not purport to be comprehensive. Depending on the circumstances, application of the proposals may lead auditors to take other actions.
- While actions in the flow chart are shown in a certain sequence, they may not need to be taken in the same order in practice.
- No flow chart can fully capture all the complexities that may arise when auditors come across a serious act or suspected act of NOCLAR in practice.
- By its nature, a flow chart is static and will not capture the dynamic interactions among all the relevant players in the circumstances or the fluidity of the particular situation.

### Illustrative Flow Chart – Auditor Responding to Suspected Fraud





## **PROPOSED CHANGES TO THE IESBA *CODE OF ETHICS FOR PROFESSIONAL ACCOUNTANTS***

### **PROPOSED SECTION 225**

#### **Responding to Non-Compliance with Laws and Regulations**

##### **Purpose**

- 225.1 In the course of providing a professional service to a client, a professional accountant in public practice may come across non-compliance or suspected non-compliance with laws and regulations. The purpose of this section is to guide the professional accountant in assessing the implications of such non-compliance and the possible courses of action in responding to it.
- 225.2 Non-compliance with laws and regulations comprises acts of omission or commission, intentional or unintentional, committed by a client, or by those charged with governance, management or employees of a client which are contrary to the prevailing laws or regulations.
- 225.3 A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. When responding to non-compliance or suspected non-compliance with laws and regulations, the objectives of the professional accountant are:
- (a) To comply with the fundamental principles of integrity and professional behavior;
  - (b) By alerting management or, where appropriate, those charged with governance of the client, to seek to:
    - (i) Enable them to rectify, remediate or mitigate the consequences of the identified or suspected non-compliance; or
    - (ii) Deter the commission of the non-compliance where it has not yet occurred; and
  - (c) To take such further action as may be needed in the public interest.
- 225.4 What constitutes the public interest will depend on:
- (a) The facts and circumstances of the non-compliance or suspected non-compliance; and
  - (b) The nature and extent of the immediate or ongoing consequences to the client, investors, creditors, employees or the wider public.

##### **Scope**

- 225.5 This section addresses:
- (a) Laws and regulations generally recognized 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.



- 225.6 Examples of laws and regulations which this section addresses include those that deal with:
- Fraud, corruption and bribery.
  - Money laundering, terrorist financing and proceeds of crime.
  - Securities markets and trading.
  - Banking and other financial products and services.
  - Tax and pension liabilities and payments.
  - Environmental protection.
  - Public health and safety.
- 225.7 Non-compliance with those laws and regulations may result in fines, litigation or other consequences for the client that may have a material effect on its financial statements. Importantly, such non-compliance may have wider public interest implications in terms of potentially substantial harm to the wider public, including investors, creditors or employees. Examples include the perpetration of a fraud resulting in significant financial losses to investors, and breaches of environmental laws and regulations endangering the health or safety of employees or the public.
- 225.8 This section does not address:
- (a) Matters that are clearly inconsequential, judged by their nature and their impact, financial or otherwise, on the client, its stakeholders or the wider public;
  - (b) Personal misconduct unrelated to the business activities of the client; and
  - (c) Non-compliance with laws and regulations committed by persons other than the client, those charged with governance, management or employees of the client. The professional accountant may nevertheless find the guidance in this section helpful in considering how to respond in these situations.

### **Responsibilities of the Client’s Management and Those Charged with Governance**

- 225.9 It is the responsibility of the client’s management, with the oversight of those charged with governance, to ensure that the client’s business activities are conducted in accordance with laws and regulations. It is also the responsibility of management and those charged with governance to identify and address any non-compliance with laws and regulations by the client or by those charged with governance, management or employees of the client.

### **Responsibilities of Professional Accountants Performing Audits of Financial Statements**

#### *Complying with Applicable Laws and Regulations*

- 225.10 In some jurisdictions, there are legal or regulatory provisions governing how professional accountants should address non-compliance or suspected non-compliance with laws and regulations. The professional accountant shall obtain an understanding of those provisions and comply with them, including any prohibitions on alerting (“tipping-off”) the client prior to making any disclosure, for example, pursuant to anti-money laundering legislation.

*Obtaining an Understanding of the Matter*

- 225.11 If, in the course of performing an audit of financial statements, 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 obtain an understanding of the matter, including:
- The nature of the act and the circumstances in which it has occurred or may occur; and
  - The application of the relevant laws and regulations to the circumstances.
- 225.12 If the professional accountant suspects that non-compliance with laws and regulations has occurred or may occur, the professional accountant shall discuss the matter with the appropriate level of management and, where appropriate, those charged with governance.
- 225.13 Such discussion serves to clarify the professional accountant's understanding of the facts and circumstances relevant to the matter and its potential consequences. The information conveyed by the professional accountant may prompt management or those charged with governance to investigate the matter.
- 225.14 The professional accountant is expected to apply knowledge, judgment and expertise, but is not expected to have detailed knowledge of laws and regulations beyond that which is required for the audit. Whether an act constitutes actual non-compliance is ultimately a matter for determination by an appropriate legal or adjudicative body. Depending on the nature and significance of the matter, the professional accountant may consult on a confidential basis with others within the firm, a network firm, a relevant professional body, or legal counsel.
- 225.15 The appropriate level of management with whom to discuss the matter is a question of professional judgment. Relevant factors to consider include:
- The nature and circumstances of the matter.
  - The individuals actually or potentially involved.
  - The likelihood of collusion.
  - The potential consequences of the matter.
  - Whether that level of management is able to investigate the matter and take appropriate action.
- 225.16 The appropriate level of management is generally at least one level above the person or persons involved or potentially involved in the matter. If the professional accountant believes that management is involved in the non-compliance or suspected non-compliance, the professional accountant shall discuss the matter with those charged with governance. The professional accountant may also consider discussing the matter with internal auditors, where applicable. In the context of a group, the appropriate level may be management at an entity that controls the client.

*Addressing the Matter with Management and Those Charged with Governance*

- 225.17 If management and, where appropriate, those charged with governance agree that non-compliance has occurred or may occur, the professional accountant shall prompt them to take appropriate and timely actions, if they have not already done so, to:
- (a) Rectify, remediate or mitigate the consequences of the non-compliance;

- (b) Deter the commission of the non-compliance where it has not yet occurred; or
  - (c) Disclose the matter to an appropriate authority where required by law or regulation or where considered necessary in the public interest.
- 225.18 The professional accountant shall consider whether the client's management and those charged with governance understand their legal or regulatory responsibilities with respect to the matter. If not, the professional accountant may suggest appropriate sources of information or recommend that they obtain legal advice.
- 225.19 The professional accountant shall comply with applicable:
- (a) Laws and regulations, including legal or regulatory provisions governing the reporting of non-compliance or suspected non-compliance with laws and regulations to an appropriate authority. In this regard, some laws and regulations may stipulate a period within which reports are to be made; and
  - (b) Requirements under professional standards, including those relating to:
    - Communication with those charged with governance.
    - Communication with the group engagement team in the case of a group audit.
    - Consideration of the implications of the matter for the auditor's report, including disclosure in the report.

*Determining Whether Further Action is Needed*

- 225.20 The professional accountant shall determine if further action is needed to achieve the professional accountant's objectives under this section.
- 225.21 Whether further action is needed, and the nature and extent of it, will depend on various factors, including:
- The legal and regulatory framework.
  - The appropriateness and timeliness of the response of management and, where applicable, those charged with governance.
  - The urgency of the matter.
  - The pervasiveness of the matter throughout the client.
  - Whether the professional accountant continues to have confidence in the integrity of management and, where applicable, those charged with governance.
  - Whether the non-compliance or suspected non-compliance is likely to recur.
  - Whether there is credible evidence of actual or potential substantial harm to the interests of the entity, investors, creditors, employees or the wider public. An act that causes substantial harm is one that results in serious adverse consequences to any of these parties in financial or non-financial terms.
- 225.22 Relevant factors to consider in judging the appropriateness of the response of management and those charged with governance include whether:
- The non-compliance or suspected non-compliance has been adequately investigated.

- Action has been, or is being, taken to rectify, remediate or mitigate the consequences of any non-compliance.
- Action has been, or is being, taken to deter the commission of any non-compliance where it has not yet occurred.
- Appropriate steps have been, or are being, taken to reduce the risk of re-occurrence, for example, additional controls or training.
- The non-compliance or suspected non-compliance has been disclosed to an appropriate authority where appropriate and, if so, whether the disclosure appears adequate.

225.23 Examples of circumstances that may cause the professional accountant no longer to have confidence in the integrity of management and, where applicable, those charged with governance include situations where:

- The professional accountant suspects or has evidence of their involvement or intended involvement in any non-compliance.
- The professional accountant is aware that they have knowledge of such non-compliance and, contrary to legal or regulatory requirements, have not reported, or authorized reporting of, the matter to an appropriate authority within a reasonable period.

225.24 Further action may include:

- Disclosing the matter to an appropriate authority notwithstanding that there is no legal or regulatory requirement to do so.
- Withdrawing from the engagement and the professional relationship where permitted by law or regulation.

225.25 In determining the nature and extent of further action needed, the professional accountant shall exercise professional judgment and take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances available to the professional accountant at the time, would be likely to conclude that the professional accountant has acted appropriately in the public interest.

225.26 As consideration of the matter may involve complex analysis and judgments, the professional accountant may consider obtaining legal advice to understand the professional accountant's options and the professional or legal implications of taking any particular course of action. The professional accountant may also consider consulting on a confidential basis with a regulator or relevant professional body.

#### Determining Whether to Disclose the Matter to an Appropriate Authority

225.27 The purpose of disclosing the matter to an appropriate authority is to enable that authority to cause the matter to be investigated and action to be taken in the public interest. The determination of whether to make such a disclosure depends in particular on the nature and extent of the actual or potential harm from the matter to the wider public, including the investing public, creditors or employees. For example, the professional accountant may determine that disclosure of the matter to an appropriate authority is an appropriate course of action if:

- The client is a regulated entity and the matter is of such significance as to threaten its license to operate.

- The client is listed on a securities exchange and the matter could result in adverse consequences to the fair and orderly market in the client's securities or pose a systemic risk to the financial markets.
- Products harmful to public health or safety would be likely to be sold by the entity.

The determination of whether to make such a disclosure will also depend on external factors such as:

- Whether there is an appropriate authority that is able to receive the information, and cause the matter to be investigated and action to be taken.
- Whether there exists robust and credible protection from civil, criminal or professional liability or retaliation afforded by legislation or regulation, such as under whistle-blowing legislation or regulation.
- Whether there are actual or potential threats to the physical safety of the professional accountant or other individuals.

Disclosure would be precluded if it would be contrary to law or regulation.

225.28 The appropriate authority will depend on the nature of the matter, for example, a securities regulator in the case of fraudulent financial reporting or an environmental protection agency in the case of a breach of environmental laws and regulations.

225.29 If the professional accountant determines that disclosure of the matter to an appropriate authority is an appropriate course of action in the circumstances, this will not be considered a breach of the duty of confidentiality under Section 140 of this Code. When making such disclosure, the professional accountant shall act in good faith and exercise caution when making statements and assertions. The professional accountant shall also consider whether it is appropriate to inform the client of the professional accountant's intentions before disclosing the matter.

#### Withdrawal from the Engagement and the Professional Relationship

225.30 Where the professional accountant determines that withdrawing from the engagement and the professional relationship would be appropriate, doing so would not be a substitute for taking other actions that may be needed to achieve the professional accountant's objectives under this section. In some jurisdictions, however, there may be limitations as to the further actions available to the professional accountant and withdrawal may be the only available course of action. When withdrawing from the professional relationship, the professional accountant shall comply with the requirements of section 210.

#### *Documentation*

225.31 *International Standards on Auditing (ISAs)* require a professional accountant performing an audit of financial statements to:

- Prepare documentation sufficient to enable an understanding of significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions;
- Document discussions of significant matters with management, those charged with governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place; and

- Include in the documentation identified or suspected non-compliance with laws and regulations, and the results of discussion with management and, where applicable, those charged with governance and other parties outside the entity.

225.32 Where the professional accountant concludes that an identified or suspected non-compliance with laws and regulations is a significant matter, the professional accountant shall, in addition to complying with the documentation requirements under the ISAs, document:

- How management and, where applicable, those charged with governance have responded to the matter.
- The courses of action the professional accountant considered, the judgments made and the decisions that were taken, having regard to the reasonable and informed third party perspective.
- How the professional accountant is satisfied that the professional accountant's objectives under this section have been met.

### **Responsibilities of Professional Accountants in Public Practice Providing Professional Services Other Than Audits of Financial Statements**

#### *Complying with Applicable Laws and Regulations*

225.33 In some jurisdictions, there are legal or regulatory provisions governing how professional accountants should address non-compliance or suspected non-compliance with laws and regulations. The professional accountant shall obtain an understanding of those provisions and comply with them, including any prohibitions on alerting (“tipping-off”) the client prior to making any disclosure, for example, pursuant to anti-money laundering legislation.

#### *Obtaining an Understanding of the Matter and Addressing It with Management and Those Charged with Governance*

225.34 If, in the course of providing a professional 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 to obtain an understanding of the matter, including:

- The nature of the act and the circumstances in which it has occurred or may be about to occur; and
- The application of the relevant laws and regulations to the circumstances.

225.35 If the professional accountant suspects that non-compliance with laws and regulations has occurred or may occur, the professional accountant shall discuss the matter with the appropriate level of management and, if the professional accountant has access to them and where appropriate, those charged with governance.

225.36 Such discussion serves to clarify the professional accountant's understanding of the facts and circumstances relevant to the matter and its potential consequences. The information conveyed by the professional accountant may prompt management or those charged with governance to investigate the matter.

225.37 The professional accountant is expected to apply knowledge, judgment and expertise, but is not expected to have detailed knowledge of laws and regulations beyond that which is required for

the professional service for which the accountant was engaged. Whether an act constitutes actual non-compliance is ultimately a matter for determination by an appropriate legal or adjudicative body. Depending on the nature and significance of the matter, the professional accountant may consult on a confidential basis with others within the firm, a network firm, a relevant professional body, or legal counsel.

- 225.38 The appropriate level of management with whom to discuss the matter is a question of professional judgment. Relevant factors to consider include:
- The nature and circumstances of the matter.
  - The individuals actually or potentially involved.
  - The likelihood of collusion.
  - The potential consequences of the matter.
  - Whether that level of management is able to investigate the matter and take appropriate action.
- 225.39 If the professional accountant is performing a non-audit service for an audit client of the firm, the professional accountant shall communicate the matter within the firm. This is to enable the engagement partner for the audit to be informed about it and to determine how it should be addressed in accordance with the provisions of this section.
- 225.40 If the professional accountant is performing a non-audit service for an audit client of a network firm, the professional accountant shall consider whether to communicate the matter to the network firm so as to enable the engagement partner for the audit to be informed about it.

*Determining Whether Further Action is Needed*

- 225.41 The professional accountant shall also consider whether further action is needed to achieve the professional accountant's objectives under this section.
- 225.42 Whether further action is needed, and the nature and extent of it, will depend on factors such as:
- The legal and regulatory framework.
  - The appropriateness and timeliness of the response of management and, where applicable, those charged with governance.
  - The urgency of the matter.
  - The involvement of management or those charged with governance in the matter.
  - The likelihood of substantial harm to the interests of the client, investors, creditors, employees or the wider public.
- 225.43 Further action may include:
- If the client is not an audit client of the firm or a network firm, disclosing the matter to the external auditor, if any.
  - Disclosing the matter to an appropriate authority notwithstanding that there is no legal or regulatory requirement to do so.

- 225.44 In considering whether to disclose outside the client, relevant factors to take into account include:
- Whether doing so would be contrary to law or regulation.
  - Whether the terms or nature of the engagement precludes disclosure of information about the client to third parties, such as where legal privilege exists which extends to the professional accountant.
  - Whether there are restrictions about disclosure imposed by a regulatory agency or prosecutor (for example, to avoid tipping-off) in an ongoing investigation into the non-compliance or suspected non-compliance.
- 225.45 If the professional accountant determines that disclosure of the matter to an appropriate authority is an appropriate course of action in the circumstances, this will not be considered a breach of the duty of confidentiality under Section 140 of this Code. When making such disclosure, the professional accountant shall act in good faith and exercise caution when making statements and assertions. The professional accountant shall also consider whether it is appropriate to inform the client of the professional accountant's intentions before disclosing the matter.
- 225.46 The professional accountant may consider obtaining legal advice to understand the professional or legal implications of taking any particular course of action. The professional accountant may also consider consulting on a confidential basis with a regulator or relevant professional body.

*Considering Whether to Remain Associated with the Client*

- 225.47 To comply with the fundamental principles of integrity and professional behavior, the professional accountant shall consider whether the professional accountant can remain associated with the client.

*Documentation*

- 225.48 Where the professional accountant concludes that an identified or suspected non-compliance with laws and regulations is a significant matter, the professional accountant is encouraged to document:
- The matter.
  - The results of discussion with management and, where applicable, those charged with governance and other parties.
  - How management and, where applicable, those charged with governance have responded to the matter.
  - The courses of action the professional accountant considered, the judgments made and the decisions that were taken.
  - How the professional accountant is satisfied that the professional accountant's objectives under this section have been met.



**PROPOSED SECTION 360****Responding to Non-Compliance with Laws and Regulations****Purpose**

- 360.1 In the course of carrying out their employment responsibilities, a professional accountant in business may come across non-compliance or suspected non-compliance with laws and regulations. The purpose of this section is to guide the professional accountant in assessing the implications of such non-compliance and the possible courses of action in responding to it.
- 360.2 Non-compliance with laws and regulations comprises acts of omission or commission, intentional or unintentional, committed by the professional accountant's employing organization or by those charged with governance, management or employees of the employing organization which are contrary to the prevailing laws or regulations.
- 360.3 A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. When responding to non-compliance or suspected non-compliance with laws and regulations, the objectives of the professional accountant are:
- (a) To comply with the fundamental principles of integrity and professional behavior;
  - (b) By alerting management or, where appropriate, those charged with governance of the employing organization, to seek to:
    - (i) Enable them to rectify, remediate or mitigate the consequences of the identified or suspected non-compliance; or
    - (ii) Deter the commission of the non-compliance where it has not yet occurred; and
  - (c) To take such further action as may be needed in the public interest.
- 360.4 What constitutes the public interest will depend on:
- (a) The facts and circumstances of the non-compliance or suspected non-compliance; and
  - (b) The nature and extent of the immediate or ongoing consequences to the employing organization, investors, creditors, employees or the wider public.

**Scope**

- 360.5 This section addresses:
- (a) Laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the employing organization'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 employing organization's financial statements, but compliance with which may be fundamental to the operating aspects of the employing organization's business, to its ability to continue its business, or to avoid material penalties.
- 360.6 Examples of laws and regulations which this section addresses include those that deal with:
- Fraud, corruption and bribery.
  - Money laundering, terrorist financing and proceeds of crime.
  - Securities markets and trading.

- Banking and other financial products and services.
- Tax and pension liabilities and payments.
- Environmental protection.
- Public health and safety.

360.7 Non-compliance with those laws and regulations may result in fines, litigation or other consequences for the employing organization that may have a material effect on its financial statements. Importantly, such non-compliance may have wider public interest implications in terms of potentially substantial harm to the wider public, including investors, creditors or employees. Examples include the perpetration of a fraud resulting in significant financial losses to investors, and breaches of environmental laws and regulations endangering the health or safety of employees or the public.

360.8 This section does not address:

- (a) Matters that are clearly inconsequential, judged by their nature and their impact, financial or otherwise, on the employing organization, its stakeholders or the wider public;
- (b) Personal misconduct unrelated to the business activities of the employing organization; and
- (c) Non-compliance with laws and regulations committed by persons other than the employing organization or those charged with governance, management or employees of the employing organization. The professional accountant may nevertheless find the guidance in this section helpful in considering how to respond in these situations.

### **Responsibilities of the Employing Organization's Management and Those Charged with Governance**

360.9 It is the responsibility of the employing organization's management, with the oversight of those charged with governance, to ensure that the employing organization's business activities are conducted in accordance with laws and regulations. It is also the responsibility of management and those charged with governance to identify and address any non-compliance with laws and regulations by the employing organization or by those charged with governance, management or employees of the employing organization.

### **Responsibilities of Professional Accountants in Business**

360.10 In some jurisdictions, there are legal or regulatory provisions governing how professional accountants should address non-compliance or suspected non-compliance with laws and regulations. The professional accountant shall obtain an understanding of those provisions and comply with them.

360.11 Many employing organizations have established protocols and procedures (for example, an ethics policy) regarding how non-compliance or suspected non-compliance with laws and regulations by the employing organization should be raised internally. Such protocols and procedures may allow for matters to be reported anonymously through designated channels. If these protocols and procedures exist within the professional accountant's employing organization, the professional accountant shall consider them in determining how to respond to the matter.

**Responsibilities of Senior Professional Accountants in Business**

- 360.12 Senior professional accountants in business are directors, officers or senior employees able to exert significant influence over, and make decisions regarding, the acquisition, deployment and control of the employing organization's human, financial, technological, physical and intangible resources. Because of their roles, positions and spheres of influence within the employing organization, there is a greater expectation for them to take whatever action is appropriate in the public interest to respond to non-compliance or suspected non-compliance with laws and regulations than other professional accountants within the employing organization.
- 360.13 Paragraphs 360.14-29 and 360.35 apply to senior professional accountants in business.

*Obtaining an Understanding of the Matter*

- 360.14 If, in the course of carrying out employment responsibilities, a professional accountant becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws and regulations, the professional accountant shall obtain an understanding of the matter, including:
- The nature of the act and the circumstances in which it has occurred or may occur;
  - The application of the relevant laws and regulations to the circumstances; and
  - The potential consequences to the employing organization, investors, creditors, employees or the wider public.
- 360.15 The professional accountant is expected to apply knowledge, judgment and expertise, but is not expected to have detailed knowledge of laws and regulations beyond that which is required for the professional accountant's role within the employing organization. Whether an act constitutes actual non-compliance is ultimately a matter for determination by an appropriate legal or adjudicative body. Depending on the nature and significance of the matter, the professional accountant may cause, or take appropriate steps to cause, the matter to be investigated internally. The professional accountant may also consult on a confidential basis with others within the employing organization, a relevant professional body or legal counsel.

*Addressing the Matter*

- 360.16 If non-compliance has occurred or may occur, the professional accountant shall, subject to paragraph 360.11, discuss the matter with the professional accountant's immediate superior, if any, to enable a determination to be made as to how the matter should be addressed. If the professional accountant's immediate superior appears to be involved in the matter, the professional accountant shall discuss the matter with the next higher level of authority within the employing organization.
- 360.17 The professional accountant shall also take appropriate steps to:
- (a) Have the matter communicated with those charged with governance to obtain their concurrence regarding appropriate actions to take to respond to the matter and to enable them to fulfill their responsibilities;
  - (b) Comply with applicable laws and regulations, including legal or regulatory provisions governing the reporting of non-compliance or suspected non-compliance with laws and regulations to an appropriate authority;

- (c) Have the consequences of the non-compliance or suspected non-compliance rectified, remediated or mitigated;
- (d) Reduce the risk of re-occurrence; and
- (e) Seek to deter the commission of the non-compliance if it has not yet occurred.

360.18 The professional accountant shall also disclose the matter to the employing organization's external auditor, if any, pursuant to the professional accountant's duty or legal obligation to provide all information necessary to enable the auditor to perform the audit.

*Determining Whether Further Action is Needed*

360.19 The professional accountant shall determine if further action is needed to achieve the professional accountant's objectives under this section.

360.20 Whether further action is needed, and the nature and extent of it, will depend on various factors, including:

- The legal and regulatory framework.
- The appropriateness and timeliness of the response of the professional accountant's superiors, if any, and those charged with governance.
- The urgency of the matter.
- The pervasiveness of the matter throughout the employing organization.
- Whether the professional accountant continues to have confidence in the integrity of the professional accountant's superiors and those charged with governance.
- Whether the non-compliance or suspected non-compliance is likely to recur.
- Whether there is credible evidence of actual or potential substantial harm to the interests of the employing organization, investors, creditors, employees or the wider public. An act that causes substantial harm is one that results in serious adverse consequences to any of these parties in financial or non-financial terms.

360.21 Relevant factors to consider in assessing the appropriateness of the response of the professional accountant's immediate superior, if any, and those charged with governance include whether:

- They have taken or authorized appropriate action to seek to rectify, remediate or mitigate the consequences of the non-compliance, or to avert the non-compliance if it has not yet occurred.
- The matter has been disclosed to an appropriate authority where appropriate and, if so, whether the disclosure appears adequate.

360.22 Examples of circumstances that may cause the professional accountant no longer to have confidence in the integrity of those charged with governance include situations where:

- The professional accountant suspects or has evidence of their involvement or intended involvement in any non-compliance.
- Contrary to legal or regulatory requirements, they have not reported the matter, or authorized the matter to be reported, to an appropriate authority within a reasonable period.

360.23 Further action may include:

- Informing the parent entity of the matter if the employing organization is a member of a group.
- Disclosing the matter to an appropriate authority notwithstanding that there is no legal or regulatory requirement to do so.
- Resigning from the employing organization.

360.24 In determining the nature and extent of any further action needed, the professional accountant shall exercise professional judgment and take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances available to the professional accountant at the time, would be likely to conclude that the professional accountant has acted appropriately in the public interest.

360.25 As consideration of the matter may involve complex analysis and judgments, the professional accountant may consider obtaining legal advice to understand the professional accountant's options and the professional or legal implications of taking any particular course of action. The professional accountant may also consider consulting on a confidential basis with a regulator or relevant professional body.

#### Determining Whether to Disclose the Matter to an Appropriate Authority

360.26 The purpose of disclosing the matter to an appropriate authority is to enable that authority to cause the matter to be investigated and action to be taken in the public interest. The determination of whether to make such a disclosure depends in particular on the nature and extent of the actual or potential harm from the matter to the wider public, including the investing public, creditors or employees. For example, the professional accountant may determine that disclosure of the matter to an appropriate authority is an appropriate course of action if:

- The employing organization is a regulated entity and the matter is of such significance as to threaten its license to operate.
- The employing organization is listed on a securities exchange and the matter could result in adverse consequences to the fair and orderly market in the employing organization's securities or pose a systemic risk to the financial markets.
- Products harmful to public health or safety would be likely to be sold by the employing organization.

The determination of whether to make such a disclosure will also depend on external factors such as:

- Whether there is an appropriate authority that is able to receive the information, and cause the matter to be investigated and action to be taken.
- Whether there exists robust and credible protection from civil, criminal or professional liability or retaliation afforded by legislation or regulation, such as under whistle blowing legislation or regulation.
- Whether there are actual or potential threats to the physical safety of the professional accountant or other individuals.

Disclosure would be precluded if it would be contrary to law or regulation.

- 360.27 The appropriate authority will depend upon the nature of the matter, for example, a securities regulator in the case of fraudulent financial reporting or an environmental protection agency in the case of a breach of environmental laws and regulations.
- 360.28 If the professional accountant determines that disclosure of the matter to an appropriate authority is an appropriate course of action in the circumstances, this will not be considered a breach of the duty of confidentiality under Section 140 of this Code. When making such disclosure, the professional accountant shall act in good faith and exercise caution when making statements and assertions.

#### Resigning from the Employing Organization

- 360.29 Where the professional accountant determines that resigning from the employing organization would be appropriate, doing so would not be a substitute for taking other actions that may be needed to achieve the professional accountant's objectives under this section. In some jurisdictions, however, there may be limitations as to the further actions available to the professional accountant and resignation may be the only available course of action.

#### Responsibilities of Other Professional Accountants in Business

- 360.30 Paragraphs 360.31-35 apply to professional accountants in business other than those who meet the description of a senior professional accountant in business in paragraph 360.12 above.
- 360.31 If, in the course of carrying out employment responsibilities, a 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 to obtain an understanding of the matter, including:
- The nature of the act and the circumstances in which it has occurred or may occur; and
  - The application of the relevant laws and regulations to the circumstances.
- 360.32 The professional accountant is expected to apply knowledge, judgment and expertise, but is not expected to have detailed knowledge of laws and regulations beyond that which is required for the professional accountant's role within the employing organization. Whether an act constitutes actual non-compliance is ultimately a matter for determination by an appropriate legal or adjudicative body. Depending on the nature and significance of the matter, the professional accountant may consult on a confidential basis with others within the employing organization, a relevant professional body or legal counsel.
- 360.33 If the professional accountant suspects that non-compliance with laws and regulations has occurred or may occur, the professional accountant shall, subject to paragraph 360.11, inform an immediate superior to enable the superior to take appropriate action. If the professional accountant's immediate superior appears to be involved in the matter, the professional accountant shall inform the next higher level of authority within the employing organization.
- 360.34 In exceptional circumstances, the professional accountant may decide that disclosure of the matter to an appropriate authority is an appropriate course of action. If the professional accountant does so pursuant to paragraph 360.26, this will not be considered a breach of the duty of confidentiality under Section 140 of this Code. When making such disclosure, the professional accountant shall act in good faith and exercise caution when making statements and assertions.

## Documentation

360.35 Where the professional accountant concludes that an identified or suspected non-compliance with laws and regulations is a significant matter, the professional accountant is encouraged to document:

- The matter.
- The results of discussion with management and, where applicable, those charged with governance and other parties.
- How management and, where applicable, those charged with governance have responded to the matter.
- The courses of action the professional accountant considered, the judgments made and the decisions that were taken.
- How the professional accountant is satisfied that the professional accountant's objectives under this section have been met.

**CONSEQUENTIAL AND CONFORMING CHANGES  
TO OTHER SECTIONS OF THE CODE  
(MARK-UP FROM EXTANT CODE)**

**SECTION 100**

**Introduction and Fundamental Principles**

...

*Fundamental Principles*

100.5 A professional accountant shall comply with the following fundamental principles:

...

- (e) Professional Behavior – to comply with relevant laws and regulations and avoid any ~~action~~ conduct that discredits the profession.

...

*Conflicts of Interest*

...

**Ethical Conflict Resolution**

100.19 A professional accountant may be required to resolve a conflict in complying with the fundamental principles.

100.20 When initiating either a formal or informal conflict resolution process, the following factors, either individually or together with other factors, may be relevant to the resolution process:

- (a) Relevant facts;
- (b) Ethical issues involved;
- (c) Fundamental principles related to the matter in question;
- (d) Established internal procedures; and
- (e) Alternative courses of action.

Having considered the relevant factors, a professional accountant shall determine the appropriate course of action, weighing the consequences of each possible course of action. If the matter remains unresolved, the professional accountant may wish to consult with other appropriate persons within the firm or employing organization for help in obtaining resolution.

100.21 Where a matter involves a conflict with, or within, an organization, a professional accountant shall determine whether to consult with those charged with governance of the organization, such as the board of directors or the audit committee.

100.22 It may be in the best interests of the professional accountant to document the substance of the issue, the details of any discussions held, and the decisions made concerning that issue.

100.23 If a significant conflict cannot be resolved, a professional accountant may consider obtaining professional advice from the relevant professional body or from legal advisors. The professional



accountant generally can obtain guidance on ethical issues without breaching the fundamental principle of confidentiality if the matter is discussed with the relevant professional body on an anonymous basis or with a legal advisor under the protection of legal privilege. ~~Instances in which the professional accountant may consider obtaining legal advice vary. For example, a professional accountant may have encountered a fraud, the reporting of which could breach the professional accountant's responsibility to respect confidentiality. The professional accountant may consider obtaining legal advice in that instance to determine whether there is a requirement to report.~~

- 100.24 If, after exhausting all relevant possibilities, the ethical conflict remains unresolved, a professional accountant shall, ~~where possible unless prohibited by law~~, refuse to remain associated with the matter creating the conflict. The professional accountant shall determine whether, in the circumstances, it is appropriate to withdraw from the engagement team or specific assignment, or to resign altogether from the engagement, the firm or the employing organization.

#### *Communicating with Those Charged with Governance*

- 100.25 When communicating with those charged with governance in accordance with the provisions of this Code, the professional accountant or firm shall determine, having regard to the nature and importance of the particular circumstances and matter to be communicated, the appropriate person(s) within the entity's governance structure with whom to communicate. If the professional accountant or firm communicates with a subgroup of those charged with governance, for example, an audit committee or an individual, the professional accountant or firm shall determine whether communication with all of those charged with governance is also necessary so that they are adequately informed.
- 100.26 In some cases, all of those charged with governance are involved in managing the entity, for example, a small business where a single owner manages the entity and no one else has a governance role. In these cases, if matters are communicated with person(s) with management responsibilities, and those person(s) also have governance responsibilities, the matters need not be communicated again with those same person(s) in their governance role. The professional accountant or firm shall nonetheless be satisfied that communication with person(s) with management responsibilities adequately informs all of those with whom the professional accountant or firm would otherwise communicate in their governance capacity.

**SECTION 140****Confidentiality**

- 140.1 The principle of confidentiality imposes an obligation on all professional accountants to refrain from:
- (a) Disclosing outside the firm or employing organization confidential information acquired as a result of professional and business relationships without proper and specific authority or unless there is a legal or professional right or duty to disclose; and
  - (b) Using confidential information acquired as a result of professional and business relationships to their personal advantage or the advantage of third parties.
- 140.2 A professional accountant shall maintain confidentiality, including in a social environment, being alert to the possibility of inadvertent disclosure, particularly to a close business associate or a close or immediate family member.
- 140.3 A professional accountant shall maintain confidentiality of information disclosed by a prospective client or employer.
- 140.4 A professional accountant shall maintain confidentiality of information within the firm or employing organization.
- 140.5 A professional accountant shall take reasonable steps to ensure that staff under the professional accountant's control and persons from whom advice and assistance is obtained respect the professional accountant's duty of confidentiality.
- 140.6 The need to comply with the principle of confidentiality continues even after the end of relationships between a professional accountant and a client or employer. When a professional accountant changes employment or acquires a new client, the professional accountant is entitled to use prior experience. The professional accountant shall not, however, use or disclose any confidential information either acquired or received as a result of a professional or business relationship.
- 140.7 The following are circumstances where professional accountants are or may be required to disclose confidential information or when such disclosure may be appropriate:
- (a) Disclosure is permitted by law and is authorized by the client or the employer;
  - (b) Disclosure is required by law, for example:
    - (i) Production of documents or other provision of evidence in the course of legal proceedings; or
    - (ii) Disclosure to the appropriate public authorities of infringements of the law that come to light; and
  - (c) There is a professional duty or right to disclose, when not prohibited by law:
    - (i) To comply with the quality review of a member body or professional body;
    - (ii) To respond to an inquiry or investigation by a member body or regulatory body;
    - (iii) To protect the professional interests of a professional accountant in legal proceedings; or
    - (iv) To comply with technical, ethics and professional standards and ethics requirements.

140.8 In deciding whether to disclose confidential information, relevant factors to consider include:

- Whether the interests of all parties, including third parties whose interests may be affected, could be harmed if the client or employer consents to the disclosure of information by the professional accountant.
- Whether all the relevant information is known and substantiated, to the extent it is practicable; when the situation involves unsubstantiated facts, incomplete information or unsubstantiated conclusions, professional judgment shall be used in determining the type of disclosure to be made, if any.
- The type of communication that is expected and to whom it is addressed.
- Whether the parties to whom the communication is addressed are appropriate recipients.

## SECTION 150

### Professional Behavior

- 150.1 The principle of professional behavior imposes an obligation on all professional accountants to comply with relevant laws and regulations and avoid any ~~action~~ conduct that the professional accountant knows or should know may discredit the profession. This includes actions or other conduct that a reasonable and informed third party, weighing all the specific facts and circumstances available to the professional accountant at that time, would be likely to conclude adversely affects the good reputation of the profession.
- 150.2 In marketing and promoting themselves and their work, professional accountants shall not bring the profession into disrepute. Professional accountants shall be honest and truthful and not:
- (a) Make exaggerated claims for the services they are able to offer, the qualifications they possess, or experience they have gained; or
  - (b) Make disparaging references or unsubstantiated comparisons to the work of others.

## SECTION 210

### Professional Appointment

#### *Client Acceptance and Continuance*

210.1 Before accepting a new client relationship, a professional accountant in public practice shall determine whether acceptance would create any threats to compliance with the fundamental principles. Potential threats to integrity or professional behavior may be created from, for example, ~~questionable~~ issues associated with the client (its owners, management or activities)-~~210.2 Client issues~~ that, if known, could threaten compliance with the fundamental principles. These include, for example, client involvement in illegal activities (such as money laundering), dishonesty, or questionable financial reporting practices or other unethical behavior.

210.23 A professional accountant in public practice shall evaluate the significance of any threats and apply safeguards when necessary to eliminate them or reduce them to an acceptable level.

Examples of such safeguards include:

- Obtaining knowledge and understanding of the client, its owners, managers and those responsible for its governance and business activities; or
- Securing the client's commitment to address the questionable issues, for example, through improveing corporate governance practices or internal controls.

210.34 Where it is not possible to reduce the threats to an acceptable level, the professional accountant in public practice shall decline to enter into the client relationship.

210.45 ~~It is recommended that a professional accountant in public practice periodically review acceptance decisions for recurring client engagements. Potential threats to compliance with the fundamental principles may have been created after acceptance that would have caused the professional accountant to decline the engagement had that information been available earlier. A professional accountant in public practice shall, therefore, periodically review whether to continue with a recurring client engagement. For example, a threat to compliance with the fundamental principles may be created by a client's unethical behavior such as improper earnings management or balance sheet valuations. If a professional accountant in public practice identifies a threat to compliance with the fundamental principles, the professional accountant shall evaluate the significance of the threats and apply safeguards when necessary to eliminate the threat or reduce it to an acceptable level. Where it is not possible to reduce the threat to an acceptable level, the professional accountant in public practice shall consider terminating the client relationship where termination is not prohibited by law or regulation.~~

#### *Engagement Acceptance*

210.56 The fundamental principle of professional competence and due care imposes an obligation on a professional accountant in public practice to provide only those services that the professional accountant in public practice is competent to perform. Before accepting a specific client engagement, a professional accountant in public practice shall determine whether acceptance would create any threats to compliance with the fundamental principles. For example, a self-interest threat to professional competence and due care is created if the engagement team does not possess, or cannot acquire, the competencies necessary to properly carry out the engagement.

210.67 A professional accountant in public practice shall evaluate the significance of threats and apply safeguards, when necessary, to eliminate them or reduce them to an acceptable level. Examples of such safeguards include:

- Acquiring an appropriate understanding of the nature of the client's business, the complexity of its operations, the specific requirements of the engagement and the purpose, nature and scope of the work to be performed.
- Acquiring knowledge of relevant industries or subject matters.
- Possessing or obtaining experience with relevant regulatory or reporting requirements.
- Assigning sufficient staff with the necessary competencies.
- Using experts where necessary.
- Agreeing on a realistic time frame for the performance of the engagement.
- Complying with quality control policies and procedures designed to provide reasonable assurance that specific engagements are accepted only when they can be performed competently.

210.78 When a professional accountant in public practice intends to rely on the advice or work of an expert, the professional accountant in public practice shall determine whether such reliance is warranted. Factors to consider include: reputation, expertise, resources available and applicable professional and ethical standards. Such information may be gained from prior association with the expert or from consulting others.

#### *Changes in a Professional Appointment*

210.89 A professional accountant in public practice who is asked to replace another professional accountant in public practice, or who is considering tendering for an engagement currently held by another professional accountant in public practice, shall determine whether there are any reasons, professional or otherwise, for not accepting the engagement, such as circumstances that create threats to compliance with the fundamental principles that cannot be eliminated or reduced to an acceptable level by the application of safeguards. For example, there may be a threat to professional competence and due care if a professional accountant in public practice accepts the engagement before knowing all the pertinent facts.

210.940 A professional accountant in public practice shall evaluate the significance of any threats. ~~Depending on the nature of the engagement, this may require direct communication with the existing accountant to establish the facts and circumstances regarding the proposed change so that the professional accountant in public practice can decide whether it would be appropriate to accept the engagement. For example, the apparent reasons for the change in appointment may not fully reflect the facts and may indicate disagreements with the existing accountant that may influence the decision to accept the appointment.~~

210.11 Safeguards shall be applied when necessary to eliminate any threats or reduce them to an acceptable level. Examples of such safeguards include:

- When replying to requests to submit tenders, stating in the tender that, before accepting the engagement, contact with the existing accountant will be requested so that inquiries may be made as to whether there are any professional or other reasons why the appointment should not be accepted;

- Asking the existing accountant to provide known information on any facts or circumstances that, in the existing accountant's opinion, the proposed accountant needs to be aware of before deciding whether to accept the engagement. For example, the apparent reasons for the change in appointment may not fully reflect the facts and may indicate disagreements with the existing accountant that may influence the decision to accept the appointment; or
- Obtaining necessary information from other sources.

210.10 When the threats cannot be eliminated or reduced to an acceptable level through the application of safeguards, a professional accountant in public practice shall, unless there is satisfaction as to necessary facts by other means, decline the engagement.

210.113 An existing accountant is bound by confidentiality. Whether that professional accountant is permitted or required to discuss the affairs of a client with a proposed accountant will depend on the nature of the engagement and on:

- (a) Whether the client's permission to do so has been obtained; or
- (b) The legal or ethical requirements relating to such communications and disclosure, which may vary by jurisdiction.

Circumstances where the professional accountant is or may be required to disclose confidential information or where such disclosure may otherwise be appropriate are set out in Section 140 of Part A of this Code.

210.124 A professional accountant in public practice will generally need to obtain the client's permission, preferably in writing, to initiate discussion with an existing accountant. Once that permission is obtained, the existing accountant shall comply with relevant legal and other regulations governing such requests. Where the existing accountant provides information, it shall be provided honestly and unambiguously. If the proposed accountant is unable to communicate with the existing accountant, the proposed accountant shall take reasonable steps to obtain information about any possible threats by other means, such as through inquiries of third parties or background investigations of senior management or those charged with governance of the client.

210.13 In the case of an audit of financial statements, a professional accountant shall request the existing accountant to provide known information regarding any facts or circumstances that, in the existing accountant's opinion, the proposed accountant needs to be aware of before deciding whether to accept the engagement. If the client consents to the existing accountant disclosing any such facts or circumstances to the proposed accountant, the existing accountant shall provide the information honestly and unambiguously. If the client fails or refuses to grant the existing accountant permission to discuss the client's affairs with the proposed accountant, the existing accountant shall disclose this fact to the proposed accountant, who shall carefully consider such failure or refusal when determining whether or not to accept the appointment.

210.142 A professional accountant in public practice may be asked to undertake work that is complementary or additional to the work of the existing accountant. Such circumstances may create threats to professional competence and due care resulting from, for example, a lack of or incomplete information. The significance of any threats shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. An example of such a safeguard is notifying the existing accountant of the proposed work, which would give the existing accountant the opportunity to provide any relevant information needed for the proper conduct of the work.

## SECTION 270

### Custody of Client Assets

.....

270.3 As part of client and engagement acceptance procedures for services that may involve the holding of client assets, a professional accountant in public practice shall make appropriate inquiries about the source of such assets and consider legal and regulatory obligations. For example, if the assets were derived from illegal activities, such as money laundering, a threat to compliance with the fundamental principles would be created. In such situations, the professional accountant ~~may consider seeking legal advice~~ shall comply with the provisions of section 225.



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