

## Final Pronouncement: *Responding to Non-Compliance with Laws and Regulations*

This summary provides an overview of the International Ethics Standards Board for Accountants (IESBA)'s pronouncement, [\*Responding to Non-Compliance with Laws and Regulations\*](#).

The pronouncement contains consequential and conforming amendments to a number of sections in the IESBA *Code of Ethics for Professional Accountants* (the Code).

### **What was the objective of this project?**

The objective of the project was to develop a framework to guide auditors, other professional accountants (PAs) in public practice, and PAs in business (PAIBs) in deciding how best to act in the public interest when they become aware of non-compliance or suspected non-compliance with laws and regulations (NOCLAR).

### **What was the heart of the debate?**

It was about what is reasonable to ask of PAs, given their responsibility to act in the public interest when they encounter or are made aware of NOCLAR or suspected NOCLAR, when providing a professional service to their clients or carrying out their duties for their employer.

### **When is the pronouncement effective?**

The pronouncement is effective July 15, 2017. Early adoption is permitted.

### **Where can I find more information?**

For more information, including implementation support materials, visit the [IESBA NOCLAR web page](#) or [www.ethicsboard.org](http://www.ethicsboard.org).

## Why Was the Project Started and How Was It Informed?

The IESBA believes that the NOCLAR response framework is in the public interest.

The development of the framework was informed by appropriate research, two formal public consultations, three global roundtables, and extensive stakeholder outreach, including discussions with the IESBA Consultative Advisory Group.

### Why was the project started?

The project was started to address concerns from the regulatory community and other stakeholders about:

- The duty of confidentiality under the Code acting as a barrier to timely disclosure by auditors of fraud and other NOCLAR to regulatory and enforcement authorities in the public interest
- Auditors simply resigning from the client relationship because of identified or suspected NOCLAR without the matter being appropriately addressed
- A lack of guidance in the Code about the thought process and relevant factors to take into account in determining an appropriate course of action in responding to the matter in the public interest

The scope of the project was subsequently broadened to cover not just auditors but also other PAs in public practice and PAIBs.

### How were the IESBA deliberations informed?

The development of the pronouncement over more than six years was informed by research and extensive public consultation and stakeholder outreach, including:

- Gathering data on regulatory approaches to reporting NOCLAR in a number of jurisdictions around the world
- Two exposure drafts
- Three global roundtables in Hong Kong SAR; Brussels, Belgium; and Washington DC, USA
- Discussions with the IESBA Consultative Advisory Group on 12 separate occasions
- Numerous meetings with the international and national regulatory community including audit oversight bodies, international policymakers, investors, those charged with governance, preparers, national standards setters, professional accountancy organizations, representatives of large and small accounting firms, and other stakeholders

## Key Elements of the Response Framework and Key Intended Outcomes

The framework focuses on the desired *outcomes* in the public interest, i.e., that PAs do not turn a blind eye to the matter, that NOCLAR consequences are addressed or that NOCLAR be deterred, and that further action be taken as appropriate in the public interest.

### What is NOCLAR under the framework?

Any act of omission or commission, intentional or unintentional, committed by a client or employer, or by those charged with governance (TCWG), by management or by other individuals working for or under the direction of a client or employer which is contrary to the prevailing laws or regulations.

### What are the key intended outcomes?

Key intended outcomes in the public interest include:

- Ensuring that PAs respond in a timely way to identified or suspected NOCLAR
- Rectifying, remediating, or mitigating the adverse consequences of identified or suspected NOCLAR to stakeholders and the general public
- Deterring the commission of NOCLAR
- Stimulating increased reporting of identified or suspected NOCLAR where required by law or regulation, or where determined appropriate under the Code in the public interest

### What is the scope of laws and regulations covered?

Laws and regulations that have a nexus to PAs' professional training and expertise, i.e.:

- Laws and regulations that have a direct effect on the determination of material amounts and disclosures in the financial statements
- Other laws and regulations, compliance with which may be fundamental to the entity's business and operations, or to avoid material penalties

### What is not in the scope?

- Matters that are clearly inconsequential
- Personal misconduct unrelated to the business activities of the client or employer
- Non-compliance other than by the client or employer, or TCWG, management or other individuals working for or under the direction of the client or employer

## What Is Required of Auditors under the Framework?

The framework specifies a differential approach to responding to identified or suspected NOCLAR:

- Auditors vs. other PAs in public practice
- Senior-level PAIBs vs. other PAIBs

This approach recognizes the different remits of the different categories of PAs, the different spheres of influence, the different levels of authority, responsibility and decision making, and the different levels of public expectations.

### **Raise the identified or suspected NOCLAR with management/TCWG**

- To clarify their understanding of the matter, to substantiate/dispel their concerns, and to enable management/TCWG to investigate it
- To advise management/TCWG to:
  - Address the consequences
  - Deter the NOCLAR
  - Disclose the matter to an appropriate authority where required by law or regulation or where necessary in the public interest

### **Fulfill professional responsibilities**

- Understand and comply with applicable laws and regulations, including requirements regarding reporting to an appropriate authority and prohibitions against “tipping off”
- Comply with applicable auditing standards
- Communicate the matter appropriately in the context of a group

### **Determine if further action is needed**

- Assess appropriateness of the response of management/TCWG

- In light of that response, determine objectively if further action needed in the public interest

The nature and extent of further action needed will depend on various factors, e.g.:

- Credible evidence of substantial harm to the entity or stakeholders
- Any law prohibiting disclosure of confidential information to an outside party

Courses of further action may include:

- Disclosing the matter to an appropriate authority even if not required by law
- Withdrawing from the engagement and client relationship
  - If withdrawing, inform proposed successor of the NOCLAR

### **Imminent breach**

In exceptional circumstances, may immediately disclose the matter to an appropriate authority if imminent breach of a law or regulation that would cause substantial harm to stakeholders

### **Document, among other matters, courses of action considered, judgments made, and decisions taken**

## What Is Required of Senior-Level PAIBs under the Framework?

The framework describes a senior-level PAIB (“senior PAIB”) as a director, officer, or senior employee able to exert significant influence over, and make decisions regarding, the acquisition, deployment, and control of the organization’s human, financial, technological, physical, and intangible resources.

Senior PAIBs can play an important role within their organizations in promoting an ethics-based culture, including taking appropriate steps to implement internal systems, policies, and procedures to prevent NOCLAR.

### Overarching expectations

- Set the right tone at the top within the organization
- Establish appropriate policies and procedures to prevent NOCLAR, including whistleblowing procedures as a necessary part of good internal governance

### Fulfill professional responsibilities

Take appropriate steps to:

- Raise the identified or suspected NOCLAR with a superior/TCWG
- Understand and comply with applicable laws and regulations, including requirements to report the matter to an appropriate authority
- Rectify, remediate, or mitigate consequences
- Reduce the risk of re-occurrence
- Seek to deter the NOCLAR

Also determine whether disclosure to the external auditor, if any, is needed.

### Determine if further action is needed

- Assess appropriateness of the response of superiors, if any, and TCWG

- In light of that response, determine objectively if further action needed in the public interest

The nature and extent of further action needed will depend on various factors, e.g.:

- Credible evidence of substantial harm to the organization or stakeholders
- Any law prohibiting disclosure of confidential information to an outside party

Courses of further action may include:

- Informing management of the parent entity in the case of a member of a group
- Disclosing the matter to an appropriate authority even if not required by law
- Resigning from the employment relationship

### Imminent breach

In exceptional circumstances, may immediately disclose the matter to an appropriate authority if imminent breach of a law or regulation that would cause substantial harm to stakeholders

### Documentation is encouraged

# What Is Required of Other PAs in Public Practice and Other PAIBs under the Framework?

The basic ethical principles are 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.

## **PAs in public practice other than auditors**

- Discuss the identified or suspected NOCLAR with management and, if they have access to them and where appropriate, TCWG
- If the client is also an audit client of the firm, or a component of an audit client of the firm, communicate the matter within the firm so that the audit engagement partner is informed about it
- If the client is an audit client of a network firm, or a component of an audit client of a network firm, consider communicating the matter to the network firm so that the audit engagement partner is informed about it
- For any other client, consider communicating the matter to the firm that is the external auditor, if any

### *Stand back*

- Consider whether further action is needed in the public interest

Courses of further action may include:

- Disclosing the matter to an appropriate authority even if not required by law
- Withdrawing from the engagement and client relationship

The nature and extent of further action will depend on various factors.

### *Imminent breach*

In exceptional circumstances, may immediately disclose the matter to an appropriate authority if imminent breach of a law or regulation that would cause substantial harm to stakeholders

## **PAIBs who are not senior PAIBs**

- Escalate the identified or suspected NOCLAR to the immediate superior or next higher level of authority; or
- Use established internal whistle-blowing mechanism

**Documentation is encouraged for both PAs in public practice other than auditors, and PAIBs who are not senior PAIBs**

## What Are the Strengths of the Framework?

The Code alone cannot address issues of non-compliance. There also needs to be strong corporate governance systems; robust, trusted, and effective legal and regulatory regimes; and ongoing efforts by accounting firms, professional accountancy organizations, academic institutions and others to assist PAs in becoming more aware of and in better understanding their legal, regulatory, and ethical responsibilities regarding responding to NOCLAR.

### A holistic and balanced model

- It focuses on the desired *outcomes* in the public interest.
- It places appropriate and necessary emphasis on the actions of auditors and other PAs vis-à-vis the responsibilities of management and TCWG.
- It balances in a robust way the need for PAs to act in the public interest against considerations of global operability.

### A proportionate approach

- It recognizes the different capacities and spheres of influence, and the different levels of public expectations, for the different categories of PAs, and scales the responsibilities accordingly.

### A renewed emphasis on tone at the top

- It emphasizes the importance of senior-level PAIBs promoting a culture of compliance with laws and regulations and prevention of NOCLAR within their organizations.

### Expanded auditors' "toolkit"

- It provides a pathway to disclosure of serious identified or suspected NOCLAR to an appropriate authority in the appropriate circumstances, without the ethical duty of confidentiality standing in the way.
- If an auditor has chosen to resign from the client relationship as a result of taking this course of action in following the framework, the predecessor auditor, on being approached by a proposed successor auditor, is required to communicate information concerning the identified or suspected NOCLAR to the proposed successor without needing to obtain client consent.

### Complementing laws and regulations

- It fills a gap where laws and regulations do not address PAs' responsibilities regarding responding to NOCLAR; and in jurisdictions that do, it may well complement the legal and regulatory framework by providing necessary guidance to PAs in complying with the legal or regulatory requirements.