

NOCLAR—Draft 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 parts:
 - Section 225¹ concerning PAs in public practice;
 - Section 360² 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 (a NOCLAR or suspected 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. 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.³
4. Whether a 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 a 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.

¹ Proposed Section 225, *Responding to Non-Compliance or Suspected Non-Compliance with Laws and Regulations*

² Proposed Section 360, *Responding to Non-Compliance or Suspected Non-Compliance with Laws and Regulations*

³ 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.⁴
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, to solicit further views and input from stakeholders on the issues and tentative revised proposals. 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 roundtable input⁵ 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 schematic 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 VII below).
10. The remainder of this memorandum is structured as follows:
 - III. Proposed response framework
 - IV. Strengths of the proposed framework
 - V. Rationale for not mandating disclosure to an appropriate authority under the Code
 - VI. Broader considerations
 - VII. Coordination with IAASB
 - VIII. Analysis of the overall impact of the proposals
 - IX. Project timetable and effective date
 - X. 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 a NOCLAR or suspected NOCLAR in deciding how best to act in the public interest in the circumstances.

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

⁵ 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 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, at the level of basic principles, 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 a NOCLAR 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, through alerting management or, where appropriate, TCWG, to seek to:

- (a) Have them 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 (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 would be consistent with advice the Board has received from some national standards setters about making clear upfront what is expected of PAs when they encounter a NOCLAR or suspected 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:

- 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 a NOCLAR or suspected NOCLAR to an appropriate authority in specified circumstances (see Section V 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, notwithstanding that this was only in the context of a permission – and not a requirement – to override confidentiality under the Code to report a NOCLAR or suspected NOCLAR to an appropriate authority. The Board has therefore 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, consistent with the views of many at the roundtables.
21. For auditors, International Standard on Auditing (ISA) 250⁶ 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 these should also appropriately circumscribe the scope of their responsibilities under the Code. The Board further believes that those same categories of laws and regulations should also establish an appropriate scope 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 a 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 would be subject to the same ethical expectations as ordinary good citizens in responding to a NOCLAR or suspected NOCLAR. Those other laws and regulations would therefore be outside the scope of the proposed Sections.

⁶ ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*

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 scope of the revised proposals with that of ISA 250 would be an appropriate way forward for the reasons noted above.
25. The Board also considered whether there should be a carve-out of 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, the Board believes that there should not be a different treatment of scope for entities that are not PIEs.

EXAMPLES OF LAWS AND REGULATIONS ADDRESSED

26. The Board has proposed in Sections 225 and 360 a list of 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.
27. In its consultations with the 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 a 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 impact from a public interest perspective.
28. The Board noted that insider trading is generally extremely difficult to establish in practice. Nevertheless, in response to this suggestion, the Board has added in the list of examples a reference to laws and regulations relating to securities markets and trading, which would ordinarily address such a matter (see paragraphs 225.6 and 360.6). The Board believes that if insider trading has occurred at an institutional level, the potential adverse consequences would be more evident given the potential for substantial fines on the entity. At a personal level, however, fines would not be levied at the corporate level and there may be no significant adverse impact on the entity, reputational or otherwise, or on the wider public. Instead, individuals convicted of insider trading may face significant personal consequences.

INTERACTION WITH ISA 250

29. While the scope of laws and regulations covered by the proposed pronouncement is consistent with that of ISA 250, the Board believes that it is important to highlight how the *application* of the former in the context of the scope differs from the application of the latter. Specifically, under ISA 250, auditors will be concerned with the consequences of non-compliance that may have a material effect on the financial statements. By contrast, under the proposed pronouncement, PAs will need to have regard not only to the consequences for the entity but also to the *wider public interest implications* of the non-compliance in terms of potentially substantial harm to stakeholders, whether in financial or non-financial terms. The Board believes that this would be 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 225.22 and 360.20, last bullets, explain the meaning of the concept of “substantial harm” (see also 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 a 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 a 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 to explain the meaning of the term "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 regulation 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 did not believe that there would be an 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 act or suspected act of 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 an act of non-compliance 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 a NOCLAR 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 a NOCLAR 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 a NOCLAR or suspected NOCLAR than other PAs in public practice. This duly recognizes the particular nature of the auditor's remit and the higher public expectations of them. Accordingly, the Board proposes that auditors be required to take the actions set out below, anticipating that more will be expected of them from an ethical perspective than under the ISAs.

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 concerns a NOCLAR or suspected NOCLAR (see paragraph 225.11). This would be consistent with ISA 250 and would be a prerequisite to assessing the potential consequences of the matter to the client or stakeholders.
43. Also consistent with ISA 250, auditors must raise the matter with management and, where appropriate, TCWG if they then suspect that an act of non-compliance has been or may be committed. 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 duly investigate the matter (paragraph 225.13).

44. However, where the Board believes it would be necessary for the Code to go beyond ISA 250 in the context of this dialogue would be for auditors to prompt management and, where appropriate, TCWG to do the right thing if they agree that an act of non-compliance has been or may be committed. Appropriate actions that they could take in this regard and on a timely basis if they have not already done so would include:
- Rectifying, remediating or mitigating the consequences of the non-compliance.
 - Deterring the commission of the non-compliance 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 225.18.)
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 225.20.)
 - 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 225.20.)

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 a NOCLAR 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, given auditors' responsibility to act in the public interest. 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 225.21).
48. Whether such further action would be 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 would 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 225.22.)

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 225.25.)

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 of 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 of 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.⁷
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 interest. Further, a threshold of “substantial injury” would set 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

⁷ 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

other than English. The Board has also proposed guidance to explain the meaning of this threshold (see paragraph 225.22, last bullet).

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 225.26).
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. The Board noted a perception 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 on consideration of a number of relevant factors. The proposed framework sets out a number of these factors, balancing considerations relevant to the public interest (such as the nature and extent of the actual or potential harm to stakeholders’ interests) against practicality concerns 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 auditors or others (see paragraph 225.28).
58. If auditors 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 140⁸ 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 225.30, i.e., that such disclosure would not be considered a breach of the duty of confidentiality under the Code.
59. The Board heard of many concerns from stakeholders on the original ED as well as during the roundtables about the dilemma auditors and other PAs can face in jurisdictions that have strict

⁸ Section 140, *Confidentiality*

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 225.28).

Appropriate Authority

60. 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.

61. 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.
62. 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.
63. Recognizing these concerns, the Board proposes that the description of an appropriate authority be more clearly circumscribed to one that can receive the information and cause the matter to be investigated (paragraph 225.28). 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 225.29). 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.
64. The Board did not believe that it would be appropriate to place further constraints as to who the appropriate authority might be in terms of the capacity or effectiveness of the authority. It would be beyond the remit of the Code to call upon auditors and other PAs to make an assessment of such matters, nor would it be practicable for them to do so.

Obtaining Legal Advice or Consulting Other Sources

65. 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 225.27).

(b) SENIOR PAIBs

Description of Senior PAIBs

66. Consistent with the feedback from the roundtables, the Board believes that senior PAIBs should have a greater responsibility to take action in response to a NOCLAR or suspected NOCLAR than other PAIBs, given their decision-making ability and the expectations of them by virtue of their positions.
67. In this regard, the Board proposes to describe senior PAIBs as follows, leveraging the Board's recently revised guidance on management responsibility (revised paragraph 290.159⁹ 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

68. One of 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.
69. The Board has therefore proposed changes to Section 300¹⁰ 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 whistle-blowing 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 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~~.

70. 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

⁹ 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.”

¹⁰ Section 300, *Introduction*

bringing greater balance to the revised proposals compared with the original ED, which focused almost entirely on looking up the chain of command for an appropriate response to the issue.

Required Responses for Senior PAIBs

71. The Board believes that the response framework for senior PAIBs should be broadly comparable to that for auditors (see schematic in 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 and explanations 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
72. For these PAs, the Board believes that the extent of the required response should be lesser compared with auditors. This would be consistent with the former's generally narrower mandates and the lower level of public interest in the services they provide.
73. Accordingly, the Board proposes that for these PAs they should only be required to:
- Seek to obtain an understanding of the matter (see paragraph 225.35).
 - Discuss the matter with the appropriate level of management and, if they have access to them and where appropriate, TCWG (see paragraph 225.36). 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 (see paragraph 225.40).
 - 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 225.41). (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 225.42, 44 and 46.)
 - Also stand back and consider if they can remain associated with the client in order to comply with the fundamental principles (see paragraph 225.48).
74. 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 225.43).
75. 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 non-compliance or suspected non-compliance 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 Forensic Engagements

76. 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 forensic 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 did not believe that it would be appropriate to mandate reporting to a network firm without appropriate consideration of the context and circumstances.
77. 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 out 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.
78. The Board has, however, provided guidance on factors to consider regarding whether information can be disclosed outside the entity (see paragraph 225.45). These factors include, in particular, whether the terms or nature of the engagement would preclude disclosure to third parties, such as when there is legal privilege or similar restrictions.
79. The Board believes that articulating this particular factor would 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 forensic engagements 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.

Review and Other Assurance Engagements

80. 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 would generally have the same access to TCWG as those performing audit engagements.
81. The Board did not believe that making the split between assurance and non-assurance engagements for the proposed framework would be appropriate. This is because the provision of review and assurance engagements other than audits of financial statements varies significantly around the world, as does the level of public interest in them. Also, audits tend to be significantly more legislated or regulated than other assurance engagements.

82. 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

83. For these PAs, the Board believes that the extent of the required response should be lesser compared with 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).
- 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).

84. The Board did not believe it necessary to distinguish between different levels of seniority for these PAIBs given that the responsibilities would flow through up the chain.

85. Nothing under the proposed framework would preclude PAIBs other than 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

86. 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.

87. 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.

88. 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.

89. 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.

90. 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 225.32). 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 a NOCLAR or suspected NOCLAR judged by them to be 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 225.33.)

91. The Board believes that this documentation requirement for auditors would be 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.
92. 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 225.49 and 360.35).
93. In response to some of the concerns on the ED proposal as noted above, the Board also proposes new guidance that would apply more broadly across the Code. This new guidance draws PAs' attention to the need and underlying rationale for exercising appropriate care and diligence when they prepare documentation. Importantly, this guidance explains the benefits of documentation. (See paragraphs 100.27-28 in the consequential and conforming amendments.)
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 make the proposals unworkable.

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.¹¹
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 NOCLAR. Importantly, knowledge that such a communication requirement exists could have a

¹¹ Section 210, *Professional Appointment*, paragraph 11

deterrent effect on management and TCWG. 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.¹²

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) Through bringing the matter to the attention of management/TCWG, PAs seek to have them rectify, remediate or mitigate the consequences of the identified or suspected NOCLAR, or deter the commission of the NOCLAR; and

¹² 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,¹³ 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 non-compliance 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

¹³ The proposed changes have been issued for comment as part of the Part C Phase I [exposure draft](#).

varied significantly,¹⁴ notwithstanding that member states have some leeway in how they implement the Directive at the national level.

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 non-compliance, 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 countries, including most in the G20, have established requirements in law or regulation for auditors in particular to report NOCLAR or suspected NOCLAR to appropriate authorities.¹⁵ Many jurisdictions¹⁶ also have signed up to the Financial Action Task Force (FATF) recommendations on anti-money laundering.¹⁷

An Expanded Auditors' "Toolkit"

112. For auditors, the proposed framework would expand their "toolkit" for dealing with issues of non-compliance. 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 a deterrent effect, this measure would increase the likelihood that serious issues of non-compliance are appropriately flagged and addressed.
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.

¹⁴ 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.

¹⁵ See the [Appendix](#) to the January 2015 IESBA issues paper.

¹⁶ 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.

¹⁷ 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.

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.
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/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. Rationale for Not Mandating Disclosure to an Appropriate Authority Under the Code

118. On the basis of further consultations with stakeholders and research, the Board believes that there are a number of reasons why a disclosure requirement would not be operable in the Code.

Protection is Generally Linked to a Legal or Regulatory Reporting Requirement

119. The Board does not believe that it would 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 very 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.
120. 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.
121. For a disclosure requirement in the Code to be enforceable, the meaning of the protection would need to be clear. The Board does not believe that it would be feasible to define on a global basis the nature and extent of the protection that would be necessary for the various types of NOCLAR addressed. Effectively, only law or regulation can define such protection, having regard to the specific type of NOCLAR addressed.
122. Also, whether a disclosure requirement in the Code can be effective would 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 would be practicable to specify these as preconditions in the Code.

Potentially Severe Practical Consequences

123. Even if preconditions could be precisely defined for a disclosure requirement in the Code, the Board believes 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.¹⁸ 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 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.
124. The legal advice the Board has received also indicates that with a disclosure requirement in the Code, there would be significant scope for negligence actions both where the PA reports a NOCLAR or suspected NOCLAR to an appropriate authority and where the PA fails to report. In the former case, this would be for foreseeable losses suffered by the client (for example, costs of investigation), most likely if the report proves to be incorrect. In the latter case, this would be for foreseeable losses suffered by the victim, with failure to comply with the Code used to support the negligence argument.
125. In addition, the legal advice indicates that in some jurisdictions there would be a possibility of retaliatory action against the PA. It would not be feasible for the Code to anticipate all possible retaliatory actions against the PA for complying with a disclosure obligation in the Code, and therefore articulate the specific protections that would be needed to enable the PA to make the disclosure (as noted above). It would therefore be unreasonable for the Code to expose the PA to the possibility of severe personal consequences. In practice, it may be more likely that the PA would opt out of complying with the disclosure requirement, thus rendering the requirement ineffective.

Potential for Unintended Consequences for the Public Interest

126. 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.
127. 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 to leave the profession. The Boards believes that such unintended consequences would not be in the public interest.

VI. Broader Considerations

128. The Board recognizes that the Code operates as part of a wider framework, which needs to include strong corporate governance systems and a robust, trusted and effective legal and regulatory framework. The Board believes that all the elements of the wider framework are important in ensuring that the issue of NOCLAR is addressed holistically.

¹⁸ For example, Albania, the Bahamas, Ivory Coast, Jordan, Kenya, Lesotho, Macedonia and Zambia

129. 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 non-compliance.
 - 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.
130. The Board agrees with observations made during its consultations with the IESBA CAG that there is a broader mindset and educational issue among PAs that needs to be addressed 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 non-compliance. Effectively addressing this mindset and educational issue may contribute to a significantly improved outcome in terms of increased reporting by PAs of NOCLAR or suspected NOCLAR to appropriate authorities.

VII. Coordination with IAASB

131. The revised proposals are intended to complement ISA 250, recognizing the different objectives of the Code and the ISAs. In particular, the proposals build upon the ISA 250 process of obtaining an understanding of the matter, raising it with management/TCWG, evaluating its implications, and documenting the relevant discussions, judgments made and decisions taken.
132. The main areas where the revised proposals complement, and are distinct from, ISA 250 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 is any material impact on 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 needed.
 - Consideration of not only an act of NOCLAR that has been committed but also one that may be committed.
 - A requirement for the auditor to prompt management/TCWG to address the consequences, deter the NOCLAR, or report it to an appropriate authority.

- Requirements to understand and comply with laws and regulations and professional standards.
 - A requirement to determine such further action as may be needed in the public interest.
133. Notwithstanding these areas of complementarity, the Board has been proactively liaising with the IAASB at the staff, Task Force and board levels with a view to identifying and addressing any potential inconsistencies that may arise between the revised proposals and ISA 250 and other IAASB standards. In this regard, the IAASB has established a working group to identify and make recommendations regarding any changes that might be needed to IAASB standards to eliminate such inconsistencies, and the timing of such changes.
134. A [comparative analysis](#)¹⁹ of the revised 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 for developing any potential changes that might be needed to its standards for purposes of exposure and the timeframe for doing so. Both boards will maintain close coordination as this project progresses.

VIII. Analysis of the Overall Impact of the Proposals

135. [To be developed]

IX. Project Timetable and Effective Date

136. 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).²⁰ 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.
137. The Board will consider and communicate in due course the timing of issuance of the final changes to the Code relating to this re-ED, and therefore the effective date of these changes, taking into account developments from the Structure of the Code project. Any restructuring of the final changes to the Code arising from this re-ED will not involve changes in the meaning of the provisions.

X. Guide for Respondents

138. 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.
139. 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.

¹⁹ [To be updated for changes arising from the April 2015 IESBA discussion]

²⁰ See November 2014 Consultation Paper, [Improving the Structure of the Code of Ethics for Professional Accountants](#).

Request for Specific Comments

140. The Board would welcome views on the following specific questions:

- (a) Do respondents agree with the proposed objectives for all categories of PAs?
- (b) Do respondents agree with the scope of the revised proposals as this pertains to laws and regulations addressed?
- (c) Do respondents agree with the differential approach among the four categories of PAs regarding responding to identified or suspected NOCLAR?
- (d) For auditors and senior PAIBs:
 - (i) Do respondents agree with the factors to consider in determining the need for, and the nature and extent of, further action?
 - (ii) Do respondents agree with the threshold of credible evidence of substantial harm as one of the factors to consider in determining the need for such further action?
 - (iii) 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?
 - (iv) Do respondents agree with the examples of possible courses of further action? Are there other courses of further action respondents believe should be listed?
 - (v) Do respondents agree that the list of factors to consider in determining whether to disclose the matter to an appropriate authority is appropriately balanced?
- (e) 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 across to a network firm where the client is also an audit client of the network firm?
- (f) Do respondents agree with the approach to documentation with respect to the four categories of PAs?

Request for General Comments

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

- (a) *Preparers (including Small and Medium Entities), and users of financial statements (including regulators and investors)*—The Board invites comments on the revised proposals from preparers (particularly with respect to the practical impacts of the proposals), and users of financial statements.
- (b) *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.
- (c) *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.

- (d) *Translations*—Recognizing that many respondents may intend to translate the final changes for adoption in their own 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:

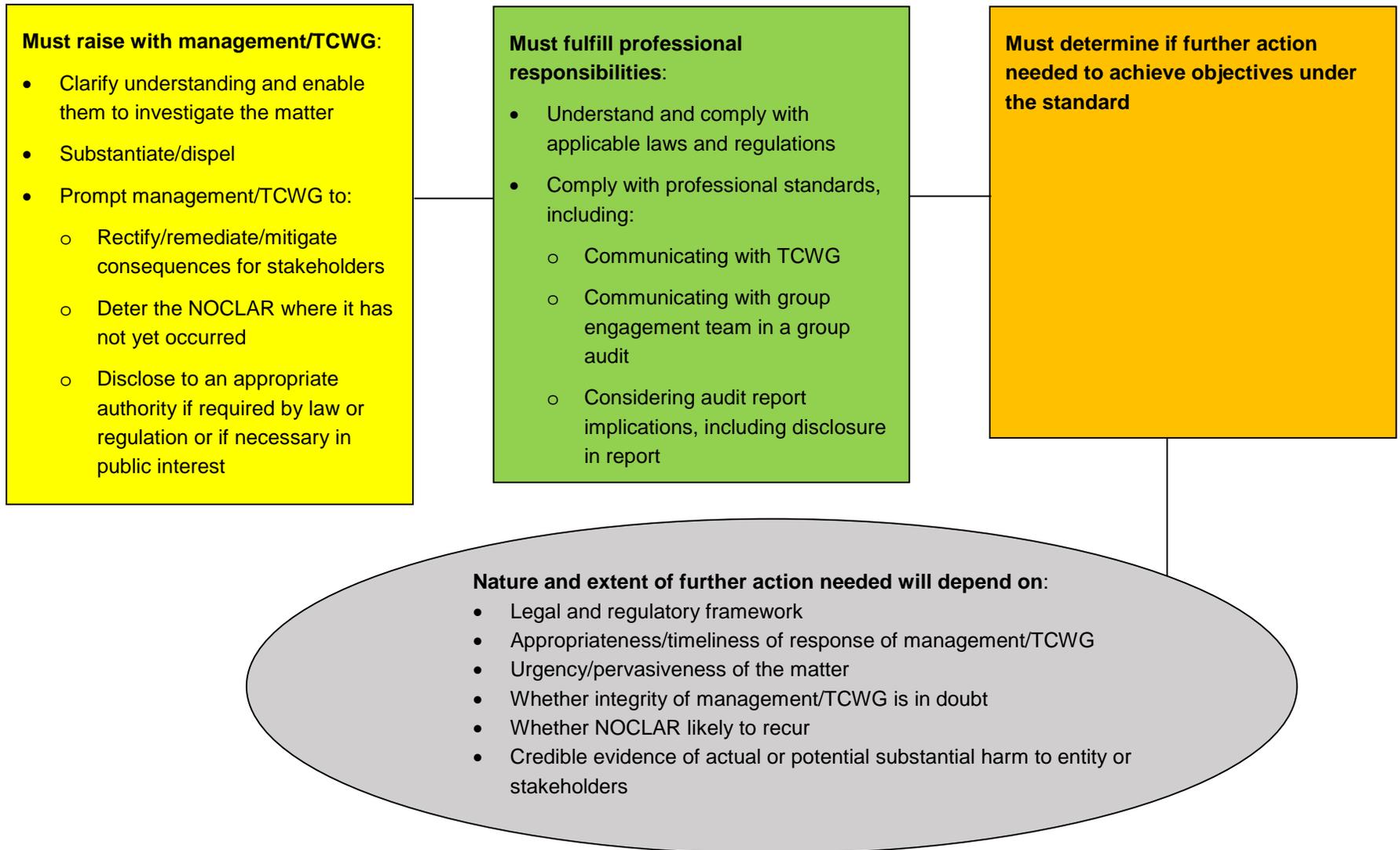
- To comply with fundamental principles of integrity and professional behavior
- Through alerting management or, where appropriate, TCWG, to seek to:
 - Have them rectify, remediate or mitigate the consequences of identified or suspected NOCLAR
 - Deter the commission of NOCLAR where it has not yet occurred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

Scope – All PAs

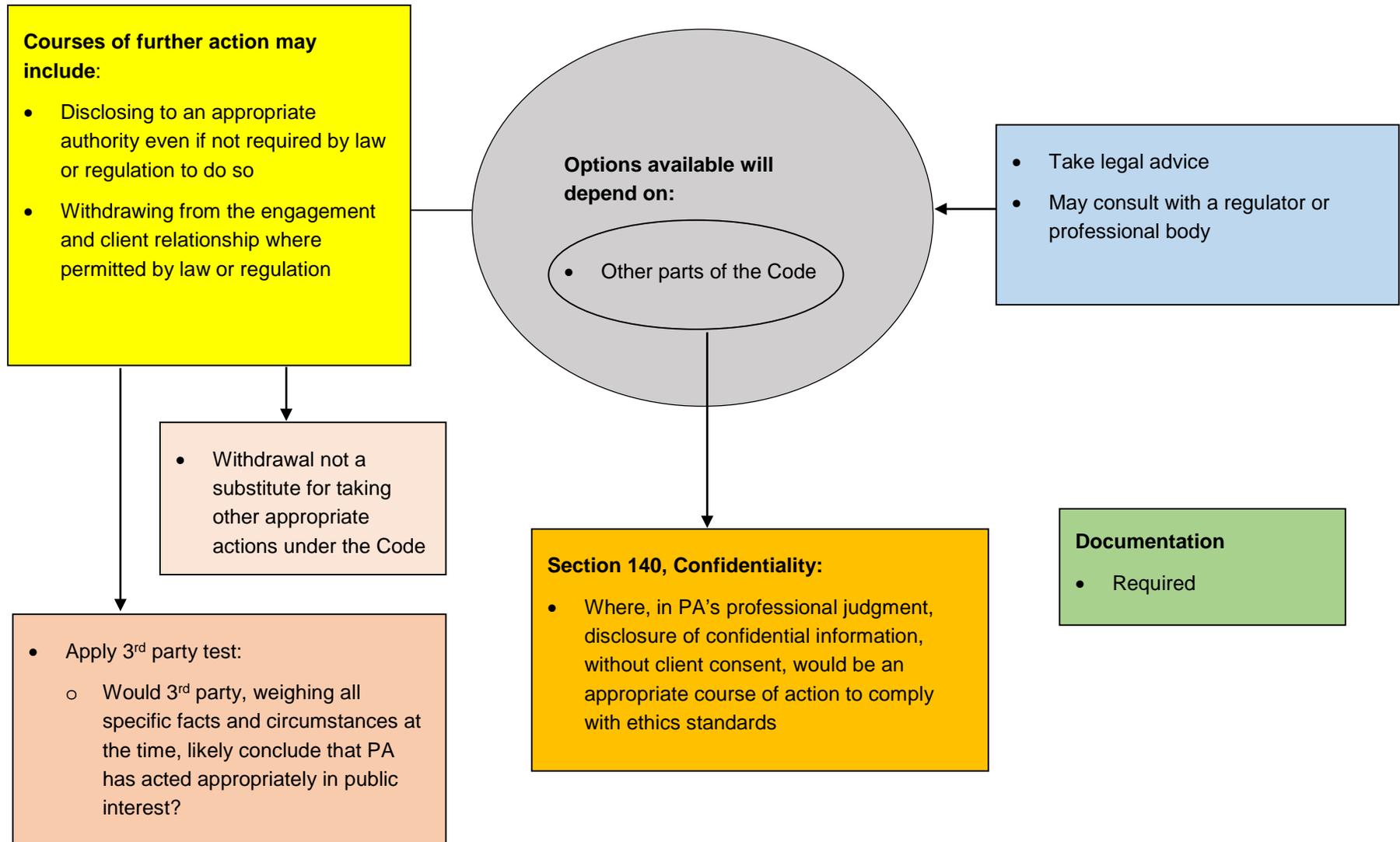
- Laws and regulations to which ISA 250 applies:²¹
 - Laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements
 - Other laws and regulations that do not have a direct effect on the determination of the amounts 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

²¹ ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*

AUDITORS – RESPONSE FRAMEWORK WHEN COMING ACROSS NOCLAR OR SUSPECTED NOCLAR



AUDITORS – DETERMINATION OF FURTHER ACTION NEEDED



SENIOR PAIBs

Senior PAIB: Director, officer or senior employee able to exert significant influence over, and make decisions regarding acquisition, deployment and control of human, financial, technological, physical and intangible resources

Overarching Expectations:

- Set the right tone at the top (Section 300)
- Establish appropriate framework to prevent NOCLAR

RESPONSE FRAMEWORK WHEN COMING ACROSS NOCLAR OR SUSPECTED NOCLAR

Must fulfill professional/ethical responsibilities:

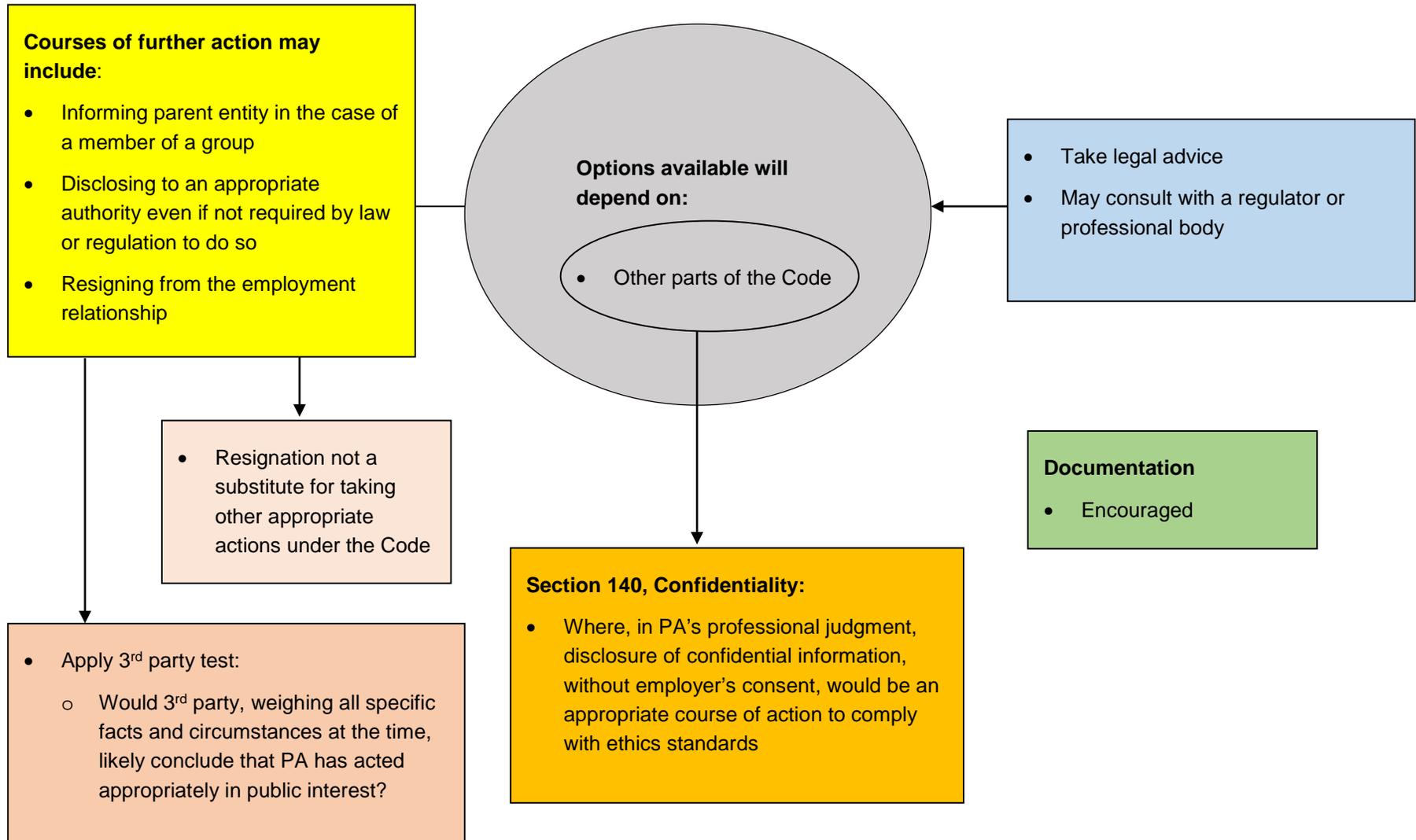
- Raise with superior and TCWG
- Understand and comply with applicable laws and regulations
- Rectify/remediate/mitigate consequences
- Seek to deter NOCLAR if it has not yet occurred
- Alert external auditor

Must determine if further action needed to achieve objectives under the standard

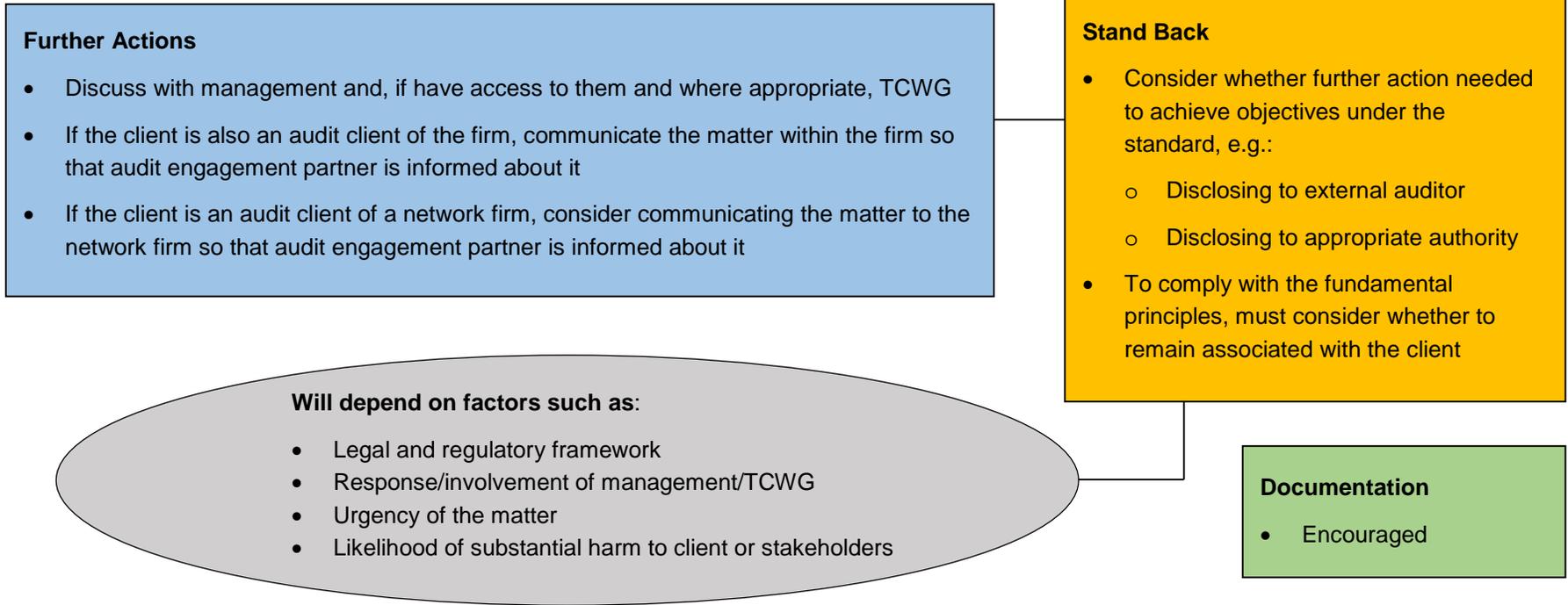
Nature and extent of further action will depend on:

- Legal and regulatory framework
- Appropriateness/timeliness of response of superior/TCWG
- Urgency/pervasiveness of the matter
- Whether integrity of TCWG is in doubt
- Likelihood of recurrence
- Credible evidence of actual or potential substantial harm to employer or stakeholders

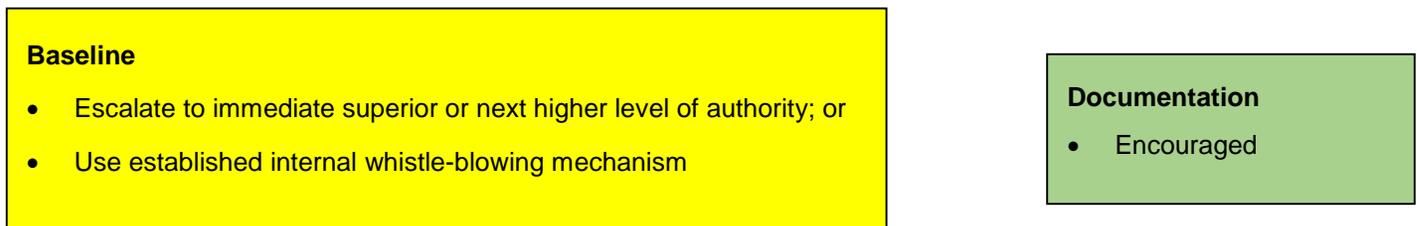
SENIOR PAIBs – DETERMINATION OF FURTHER ACTION NEEDED



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 NOCLAR or suspected 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

