

Agenda Item 2-B

PROPOSED SECTION 225

(MARK-UP FROM JANUARY 2015 IESBA MEETING—CHANGES OTHER THAN EDITORIAL CHANGES)

Responding to Non-Compliance or Suspected Non-Compliance with Laws and Regulations

Purpose

225.1 ~~The purpose of this section is to guide professional accountants in public practice in how to respond to non-compliance with laws and regulations they may come across in the course of providing a professional service to a client, a professional accountant in public practice may come across. Such non-compliance or suspected non-compliance with laws and regulations. The purpose of this section is to guide the professional accountant in assessing the implications of such non-compliance and the possible courses of action in responding to it.~~

Commented [KS1]: Introductory paragraph simplified, and reworded to avoid giving impression that this standard is addressing only serious NOCLARs.

~~(a) May have been committed or may be about to be committed by the client or by those charged with governance, management or employees of the client; and~~

~~(b) May have caused, or may cause, substantial harm to the interests of the client, investors, creditors, employees or the wider public in both financial and non-financial terms. Examples of such non-compliance include the perpetration of a major fraud resulting in significant financial losses to investors, and serious breaches of environmental laws and regulations endangering the health or safety of employees or the public.~~

Commented [KS2]: Moved to 225.7.

225.2 Non-compliance with laws and regulations comprises acts of omission or commission, intentional or unintentional, committed by a client, or by those charged with governance, management or employees of a client which are contrary to the prevailing laws or regulations. ~~Whether an act constitutes actual non-compliance is ultimately a matter for legal determination by a court of law.~~

Commented [KS3]: Moved to 225.14.

225.3 A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. ~~In acting in the public interest in these circumstances. When responding to non-compliance or suspected non-compliance with laws and regulations,~~ the objectives of the professional accountant are:

Commented [KS4]: No longer applicable as this was referring to serious NOCLARs in 225.1.

- (a) To comply with the fundamental principles of integrity and professional behavior;
- (b) Through alerting management or, where appropriate, those charged with governance of the client, to seek to:
 - (i) Have them rectify, remediate or mitigate the consequences of the identified or suspected non-compliance; or
 - (ii) Deter the commission of the non-compliance where it has not yet occurred; and
- (c) To take such further action as may be needed in the public interest.

~~225.234 The concept of the public interest is not capable of general definition. Each situation needs to be considered individually, taking into account. What constitutes the public interest will depend on:~~

Commented [KS5]: Moved from 225.23 to be closer to first reference to "public interest".

~~(a) The facts and circumstances of the non-compliance or suspected non-compliance; and~~

~~(b) The nature and extent of the immediate or ongoing consequences or potential consequences to the client, investors, creditors, employees and or the wider public.~~

Scope

225.5 This section addresses:

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

225.6 ~~The provisions of some laws or regulations have a direct effect on the client's financial statements in that they determine the reported amounts and disclosures in those financial statements, for example, tax and pension laws and regulations. Other laws or regulations are to be complied with by management and those charged with governance, or set the provisions under which the client is allowed to conduct its business but do not have a direct effect on its financial statements. These include, for example, laws and regulations which this section addresses include those that deal with:~~

- ~~Fraud, corruption and bribery.~~
- ~~Laws against money laundering, terrorist financing and proceeds of crime.~~
- ~~Securities markets and trading.~~
- ~~The provision of banking and other financial products and services.~~
- ~~Provisions for tax and pension payments and liabilities.~~
- Environmental ~~protection regulations in the chemical and extractive industries.~~
- ~~Public health and safety regulations in the agricultural, pharmaceutical and food processing industries.~~
- ~~Product safety regulations.~~

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

~~225.6 In this regard, an act of non-compliance that causes substantial harm is one that results in immediate or ongoing serious adverse consequences to the client, investors, employees or third parties in both financial and non-financial terms, such as significant financial losses, major property damage or impairment, or significant injury to public health and safety.~~

Commented [KS6]: Deleted as not adding anything substantive to 225.5.

Commented [KS7]: Bullets simplified to focus on subject matters addressed by laws and regulations.

Commented [KS8]: To address comments from IOSCO C1 re insider trading.

Commented [KS9]: To take up a suggestion at the January board meeting.

Commented [KS10]: Covered by bullet immediately above.

Commented [KS11]: Moved to 225.22, last bullet.

225.8 This section does not address:

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

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

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

Responsibilities of Professional Accountants Performing Audits of Financial Statements

Complying with Applicable Laws and Regulations

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

Obtaining an Understanding of the Matter

225.11 If, in the course of performing an audit of financial statements, the professional accountant becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws and regulations, the professional accountant shall ~~seek to~~ obtain an understanding of the matter, including:

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

225.12 If the professional accountant suspects that non-compliance with laws and regulations has been or may be committed, the professional accountant shall discuss the matter with the appropriate level of management and, where appropriate, those charged with governance.

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

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

Commented [KS12]: To be consistent with ISA 250.

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

Commented [KS13]: Moved from para 225.2.

225.15 The appropriate level of management with whom to discuss the matter is a question of professional judgment. Relevant factors to consider include:

- The nature and circumstances of the matter.
- The individuals actually or potentially involved.
- The likelihood of collusion.
- The potential consequences of the matter.
- Whether that level of management is able to investigate the matter and take appropriate action.

Commented [KS14]: To recognize that there may be no certainty.

225.16 The appropriate level of management is generally at least one level above the person or persons involved or potentially involved in the matter. If the professional accountant believes that management is involved in the non-compliance or suspected non-compliance, the professional accountant shall discuss the matter with those charged with governance. The professional accountant may also consider discussing the matter with internal auditors, where applicable. In the context of a group, the appropriate level may be management at an entity that controls the client.

225.17 The professional accountant is encouraged to obtain legal advice if:

- (a) No higher level of authority exists;
- (b) The professional accountant is unsure as to the person with whom to discuss the matter;
- (c) Insufficient information is obtained to satisfy the professional accountant that the client is in compliance with laws and regulations; or
- (d) Management or those charged with governance disagree with the professional accountant's assessment of the situation, including the potential consequences of the matter.

Addressing the Matter with Management and Those Charged with Governance

225.18 If management and, where appropriate, those charged with governance agree that ~~there is credible evidence that the non-compliance has been or may be committed and it has likely caused or would likely cause substantial harm to the interests of the client, investors, creditors, employees or the wider public,~~ the professional accountant shall ~~seek to~~ prompt them to take appropriate and timely actions, if they have not already done so, to:

Commented [KS15]: To respond to comments at the January board meeting re framework appearing to address only most serious NOCLARs.

- (a) Rectify, remediate or mitigate the consequences of the non-compliance;
- (b) Deter the commission of the non-compliance where it has not yet occurred; or
- (c) Disclose the matter to an appropriate authority where required by law or regulation or where considered necessary in the public interest.

~~225.18 Evidence is credible when it would be reasonable in the circumstances to conclude that it is likely that non-compliance has occurred or is about to occur.~~

Commented [KS16]: Deleted in response to comments at January board meeting.

225.19 The professional accountant shall consider whether the client's management and those charged with governance understand their legal or regulatory responsibilities with respect to the matter. If not, the professional accountant may suggest appropriate sources of information or recommend that they obtain legal advice.

Commented [KS17]: Suggestion from IFAC SMP Committee.

225.20 The professional accountant shall comply with applicable:

- (a) Laws and regulations, including legal or regulatory provisions governing the reporting of non-compliance or suspected non-compliance with laws and regulations to an appropriate authority. In this regard, some laws and regulations may stipulate a period within which reports are to be made; and
- (b) Requirements under professional standards, including those relating to:
 - Communication with those charged with governance.
 - Communication with the group engagement team in the case of a group audit.
 - Consideration of the implications of the matter for the auditor's report, including disclosure in the report.

Determining Whether Further Action is Needed

225.21 The professional accountant shall determine if further action is needed to achieve the professional accountant's objectives under this section, ~~and~~

(b) ~~Serve the public interest in the circumstances.~~

Commented [KS18]: To respond to comments from IFAC SMP Committee re duplicative given reference to objectives.

~~225.23 The concept of the public interest is not capable of general definition. Each situation needs to be considered individually, taking into account:~~

Commented [KS19]: Moved to 225.4.

- ~~• The facts and circumstances of the non-compliance or suspected non-compliance.~~
- ~~• The nature and extent of the consequences or potential consequences to investors, creditors, employees and the wider public.~~

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

- The legal and regulatory framework.
- The appropriateness and timeliness of the response of management and, where applicable, those charged with governance.
- The urgency of the matter.
- The pervasiveness of the matter throughout the client.
- ~~Whether the appropriateness of such response can be assessed.~~
- Whether the professional accountant continues to have confidence in the integrity of management and, where applicable, those charged with governance.
- ~~Whether those charged with governance are independent of management.~~
- ~~Whether there is a general culture within the client of disregarding laws and regulations.~~
- Whether the non-compliance or suspected non-compliance is likely to recur.

Commented [KS20]: Moved from 225.25.

Commented [KS21]: Implicit in second bullet.

Commented [KS22]: Implicit in bullet immediately above.

Commented [KS23]: To respond to comments at January board meeting.

- ~~The likelihood of continuing consequences for the client, investors, creditors, employees and the wider public.~~
- ~~Whether there is credible evidence of actual or potential substantial harm to the interests of the entity, investors, creditors, employees or the wider public. An act that causes substantial harm is one that results in immediate or ongoing serious adverse consequences to any of these parties in financial or non-financial terms.~~

Commented [KS24]: Concept already embedded in description of meaning of “substantial harm” in last bullet below re ongoing consequences.

Commented [KS25]: To respond to comments at January board meeting.

Commented [KS26]: Moved from 225.6.

225.23 Relevant factors to consider in judging the appropriateness of the response of management and those charged with governance include whether:

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

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

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

Commented [KS27]: To respond to comments at January board meeting re avoiding suggesting that management has the same responsibility as the auditor to act in the public interest.

225.25 Further action ~~will depend on the legal and regulatory framework and may include one or more of the following:~~

Commented [KS28]: Moved to list of bullets in 225.22.

- ~~Informing the parent entity of the matter in the case of the audit of the financial statements of a component within a group.~~
- Disclosing the matter to an appropriate authority notwithstanding that there is no legal or regulatory requirement to do so ~~to the extent the professional accountant reasonably believes necessary.~~
- Withdrawing from the engagement and the professional relationship where permitted by law or regulation.

Commented [KS29]: Would already be covered by 225.20(b), i.e., communication to group auditor would trigger group auditor’s responsibility to communicate to group management.

Commented [KS30]: To respond to comments at January board meeting.

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

Commented [KS31]: To maintain consistency with wording in 100.1.

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

Determining Whether to Disclose the Matter to an Appropriate Authority

225.28 In determining whether to disclose the matter to an appropriate authority, relevant factors to consider include:

- The nature and extent of the actual or potential harm to the interests of the entity, investors, creditors, employees or the wider public. For example:
 - o Whether the matter could threaten the client's ability to operate.
 - o If the client is listed on a securities exchange, whether the matter could adversely impact the fair and orderly market in the client's securities or pose a systemic risk to the financial markets.
 - o Whether products that could be harmful to public health or safety would be likely to be sold by the entity.
- ~~Whether disclosure would be contrary to law or regulation.~~
- Whether there is an appropriate authority that can receive the information and cause the matter to be investigated.
- Whether there exists robust and credible protection from civil, criminal or professional liability or retaliation afforded by legislation or regulation, such as under whistle-blowing legislation or regulation.
- Whether there are actual or potential threats to the physical safety of the professional accountant or other individuals.

Commented [KS32]: List of considerations rebalanced in response to comments at January board meeting.

Commented [KS33]: Moved to end of paragraph.

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

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

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

Withdrawal from the Engagement and the Professional Relationship

225.31 Where the professional accountant determines that withdrawing from the engagement and the professional relationship would be appropriate, doing so would not be a substitute for taking other actions that may be needed to achieve the professional accountant's objectives under this section

~~and to serve the public interest.~~ In some jurisdictions, however, there may be limitations as to the further actions available to the professional accountant and withdrawal may be the only available course of action. When withdrawing from the professional relationship, the professional accountant shall comply with the requirements of section 210.

Commented [KS34]: To avoid duplication given reference to the objectives, which already makes the link to the public interest.

Documentation

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

- ~~document.~~ Prepare documentation sufficient to enable an understanding of significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.
- ~~They also require the professional accountant to d~~Document discussions of significant matters with management, those charged with governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place. ~~;- and~~
- Include in the documentation identified or suspected non-compliance with laws and regulations, and the results of discussion with management and, where applicable, those charged with governance and other parties outside the entity.

Commented [KS35]: To be fully consistent with the wording used in the ISAs.

225.33 Where the professional accountant judges identified or suspected non-compliance with laws and regulations to be a significant matter, the professional accountant shall, in addition to complying with the documentation requirements under the ISAs, document:

Commented [KS36]: To respond to comments from IOSCO C1.

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

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

Complying with Applicable Laws and Regulations

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

Commented [KS37]: Repeated to ensure this part of Section 225 is self-contained.

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

225.35 If, in the course of providing a professional service to a client or when acting for the client, the professional accountant becomes aware of information concerning an instance of non-

compliance or suspected non-compliance with laws and regulations, the professional accountant shall seek to obtain an understanding of the matter, including:

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

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

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

225.38 The professional accountant is expected to apply knowledge, judgment and expertise, but is not expected to have detailed knowledge of laws and regulations beyond that which is required for the professional service for which the accountant was engaged. Whether an act constitutes actual non-compliance is ultimately a matter for legal determination by a court of law. Depending on the nature and significance of the matter, the professional accountant may consult on a confidential basis with others within the firm, a network firm, a relevant professional body, or legal counsel.

225.39 The appropriate level of management with whom to discuss the matter is a question of professional judgment. Relevant factors to consider include:

- The nature and circumstances of the matter.
- The individuals actually or potentially involved.
- The likelihood of collusion.
- The potential consequences of the matter.
- Whether that level of management is able to investigate the matter and take appropriate action.

~~225.40~~ If the professional accountant is performing a non-audit service for an audit client of the firm ~~or a network firm~~, the professional accountant shall communicate the matter within the firm. This is to enable consider whether to inform the engagement partner for the audit ~~about the matter. Such communication would enable the audit the engagement team to be made appropriately aware of the matter and enable to be informed about it and to a determination to be made as to how the matter it~~ should be addressed in accordance with the provisions of this section.

Commented [KS38]: Changes to respond to comments from IOSCO C1.

225.41 If the professional accountant is performing a non-audit service for an audit client of a network firm, the professional accountant shall consider whether to communicate the matter to the network firm so as to enable the engagement partner for the audit to be informed about it.

Commented [KS39]: Ditto.

Determining Whether Further Action is Needed

225.42 The professional accountant shall also consider whether further action is needed ~~beyond consideration of the professional accountant's association with the client~~ to achieve the professional accountant's objectives under this section, ~~and~~

~~(b) Serve the public interest in the circumstances.~~

225.43 Whether ~~the professional accountant can remain associated with the client~~ further action is needed, and the nature and extent of it, will depend on factors such as:

• The legal and regulatory framework.

- The appropriateness and timeliness of the response of management and, where applicable, those charged with governance.
- The urgency of the matter.
- The involvement of management or those charged with governance in the matter.
- The likelihood of substantial harm to the interests of the client, investors, creditors, employees or the wider public.

• ~~The likelihood of continuing consequences for the client, investors, creditors, employees and the wider public.~~

225.44 Further action may include:

- If the client is not an audit client of the firm or a network firm, disclosing the matter to the external auditor, ~~if any.~~
- Disclosing the matter to an appropriate authority notwithstanding that there is no legal or regulatory requirement to do so ~~to the extent the professional accountant reasonably believes necessary.~~

225.45 In considering whether to disclose outside the client, relevant factors to take into account include:

- Whether doing so would be contrary to law or regulation.
- Whether the terms or nature of the engagement preclude disclosure of information about the client to third parties, such as ~~when there is legal privilege or similar (for example, where the professional accountant is engaged by a law firm to conduct in the case of a forensic assignment services) performed under legal privilege, or where the professional accountant has been engaged by the client to deal with a legally sensitive matter under professional secrecy.~~
- Whether there are restrictions about disclosure imposed by a regulatory agency or prosecutor (for example, to avoid tipping-off) in an ongoing investigation into the non-compliance or suspected non-compliance.

225.46 If the professional accountant decides that disclosure of the matter to an appropriate authority would be an appropriate course of action in the circumstances, this would not be considered a breach of the duty of confidentiality under Section 140 of this Code. When making such disclosure, the professional accountant shall act in good faith and exercise caution when making statements and assertions. The professional accountant shall also consider whether it is

Commented [KS40]: To keep all references to client association in one place, i.e., at the back end.

Commented [KS41]: To avoid duplication given reference to the objectives.

Commented [KS42]: To keep all references to client association in one place.

Commented [KS43]: To take up suggestion from IFAC SMP Committee to cater for situations where the client does not have an external auditor.

Commented [KS44]: Redrafted as the concept of "professional secrecy" may not be understood in all jurisdictions.

appropriate to inform the client of the professional accountant's intentions before disclosing the matter.

- 225.47 The professional accountant may consider obtaining legal advice to understand the professional or legal implications of taking any particular course of action. The professional accountant may also consider consulting on a confidential basis with a regulator or relevant professional body.

Considering Whether to Remain Associated with the Client

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

Documentation

- 225.49 ~~In the case of professional services other than audits of financial statements, Where the professional accountant judges identified or suspected non-compliance with laws and regulations to be a significant matter, the professional accountant is encouraged to document: the nature and substance of the matter, the details of discussions held, and the decisions made concerning the matter, in particular if the matter could have significant consequences for the client or others.~~

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

~~Documentation provides a number of benefits, including the following:~~

- ~~It provides evidence of the professional accountant's judgments in forming conclusions.~~
- ~~It may serve to protect the professional accountant if challenged in legal or disciplinary proceedings to justify the professional accountant's actions in responding to the matter.~~
- ~~It may assist the professional accountant if required to appear before a court of law or tribunal to provide testimony regarding the matter.~~

- ~~225.46 When the matter is documented, it is important that the documentation is prepared in a careful and thoughtful manner and with appropriate diligence as it may be subject to legal discovery if the matter were to be dealt with in a court of law.~~

Commented [KS45]: Redrafted to align with the documentation provision for PAs performing audits, except that there is no requirement but only an encouragement.

Commented [KS46]: Moved to the broader Code as a consequential change to Section 100.

Commented [KS47]: Ditto.

PROPOSED SECTION 360

(MARK-UP FROM JANUARY 2015 IESBA MEETING—CHANGES OTHER THAN EDITORIAL CHANGES)

Responding to Non-Compliance or Suspected Non-Compliance with Laws and Regulations

Purpose

360.1 ~~The purpose of this section is to guide professional accountants in business in how to respond to non-compliance with laws and regulations they may come across in~~ the course of carrying out their employment responsibilities, ~~a professional accountant in business may come across non-compliance or suspected non-compliance with laws and regulations. The purpose of this section is to guide the professional accountant in assessing the implications of such non-compliance and the possible courses of action in responding to it.~~ Such non-compliance:

(a) ~~May have been committed or may be about to be committed by the professional accountant's employing organization or by those charged with governance, management or employees of the employing organization; and~~

(b) ~~May have caused, or may cause, substantial harm to the interests of the employing organization, investors, creditors, employees or the wider public in both financial and non-financial terms. Examples of such non-compliance include the perpetration of a major fraud resulting in significant financial losses to the employing organization's shareholders, and serious breaches of environmental laws and regulations endangering the health or safety of employees or the public.~~

360.2 Non-compliance with laws and regulations comprises acts of omission or commission, intentional or unintentional, committed by the professional accountant's employing organization or by those charged with governance, management or employees of the employing organization which are contrary to the prevailing laws or regulations. ~~Whether an act constitutes actual non-compliance is ultimately a matter for legal determination by a court of law.~~

360.3 A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. ~~In acting in the public interest in these circumstances~~ When responding to non-compliance or suspected non-compliance with laws and regulations, the objectives of the professional accountant are:

- (a) To comply with the fundamental principles of integrity and professional behavior;
- (b) Through alerting management or, where appropriate, those charged with governance of the employing organization, to seek to:
 - (i) Have them rectify, remediate or mitigate the consequences of the identified or suspected non-compliance; or
 - (ii) Deter the commission of the non-compliance where it has not yet occurred; and
- (c) To take such further action as may be needed in the public interest.

360.418 ~~The concept of the public interest is not capable of general definition. Each situation needs to be considered individually, taking into account~~ What constitutes the public interest will depend on:

- ~~(a) The facts and circumstances of the non-compliance or suspected non-compliance; and~~
~~(b) The nature and extent of the immediate or ongoing consequences – or potential consequences – to shareholders, the employing organization, investors, creditors, employees and/or the wider public.~~

Scope

360.5 This section addresses:

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

360.6 ~~The provisions of some laws or regulations have a direct effect on the employing organization's financial statements in that they determine the reported amounts and disclosures in those financial statements, for example, tax and pension laws and regulations. Other laws or regulations are to be complied with by management and those charged with governance, or set the provisions under which the employing organization is allowed to conduct its business but do not have a direct effect on its financial statements. These include, for e~~Examples of laws and regulations which this section addresses include those that deal with:

- Fraud, corruption and bribery.
- Laws against mMoney laundering, terrorist financing, and proceeds of crime.
- Securities markets and trading.
- The provision of financial products and services.
- Provisions for tax and pension payments and liabilities.
- Environmental protection regulations in the chemical and extractive industries.
- Public Hhealth and safety regulations in the agricultural, pharmaceutical and food processing industries.
- Product safety regulations.

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

~~360.6 In this regard, an act of non-compliance that causes substantial harm is one that results in immediate or ongoing serious adverse consequences to the employing organization, its shareholders, employees or third parties in both financial and non-financial terms, such as~~

~~significant financial losses, major property damage or impairment, or significant injury to public health and safety.~~

360.8 This section does not address:

(a) Matters that are clearly inconsequential, judged by their nature and their impact, financial or otherwise, on the employing organization, its stakeholders or the wider public; ~~and~~

(b) Personal misconduct unrelated to the business activities of the employing organization; ~~and~~

(c) Non-compliance with laws and regulations committed by persons other than the employing organization or those charged with governance, management or employees of the employing organization. The professional accountant may nevertheless find the guidance in this section helpful in considering how to respond in these situations.

Commented [KS48]: To be consistent with 225.8.

Responsibilities of the Employing Organization’s Management and Those Charged with Governance

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

Responsibilities of Professional Accountants in Business

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

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

Responsibilities of Senior Professional Accountants in Business

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

Commented [KS49]: To align with the description of management responsibility in the revised NAS provisions.

non-compliance or suspected non-compliance with laws and regulations than other professional accountants within the employing organization.

360.13 Paragraphs 360.14-29 apply to senior professional accountants in business.

Obtaining an Understanding of the Matter

360.14 If, in the course of carrying out employment responsibilities, a professional accountant becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws and regulations, the professional accountant shall obtain an understanding of the matter, including:

- The nature of the act and the circumstances in which it has been or may be committed;
- The application of the relevant laws and regulations to the circumstances; and
- The potential consequences to the employing organization, investors, creditors, employees or the wider public.

360.15 The professional accountant is expected to apply knowledge, judgment and expertise, but is not expected to have detailed knowledge of laws and regulations beyond that which is required for ~~the professional activity~~ the professional accountant's role within the employing organization's undertaking. Whether an act constitutes actual non-compliance is ultimately a matter for legal determination by a court of law. Depending on the nature and significance of the matter, the professional accountant may cause, or take appropriate steps to cause, the matter to be investigated internally. The professional accountant may also consult on a confidential basis with others within the employing organization, a relevant professional body or legal counsel.

Commented [KS50]: To not limit the knowledge, judgment and expertise to only the specific activity at hand but more appropriately to the PAIB's role within the organization.

Addressing the Matter

360.16 If ~~the professional accountant has credible evidence that the non-compliance has occurred~~ ~~been~~ or may be ~~committed~~ ~~about to occur and it has likely caused or would likely cause substantial harm to the interests of the employing organization, shareholders, creditors, employees or the wider public~~, the professional accountant shall: ~~(a) —~~ Subject to paragraph 360.110, discuss the matter with the professional accountant's immediate superior, if any, to enable a determination to be made as to how the matter should be addressed; ~~and~~ if the professional accountant's immediate superior appears to be involved in the matter, the professional accountant shall discuss the matter with the next higher level of authority within the employing organization. The professional accountant may also discuss how the matter should be addressed with one or more senior colleagues.

Commented [KS51]: To respond to comments at January board meeting.

360.17 The professional accountant shall also take appropriate steps to:

- (a) Have the matter communicated with those charged with governance to obtain their concurrence regarding appropriate actions to take to respond to the matter and to enable them to fulfill their responsibilities;
- (b) Comply with applicable laws and regulations, including legal or regulatory provisions governing the reporting of non-compliance or suspected non-compliance with laws and regulations to an appropriate authority;

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

360.18 The professional accountant shall disclose the matter to the employing organization's external auditor, if any, pursuant to the professional accountant's duty or legal obligation to provide all information and explanations necessary to enable the auditor to ~~determine appropriate actions in the context of the external perform the~~ audit.

Commented [KS52]: To better recognize the PAIB's duty or legal obligation.

~~360.15 Evidence is credible when it would be reasonable in the circumstances to conclude that it is likely that non-compliance has occurred or is about to occur.~~

Determining Whether Further Action is Needed

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

~~(b) Serve the public interest in the circumstances.~~

~~360.18 The concept of the public interest is not capable of general definition. Each situation needs to be considered individually, taking into account:~~

- ~~• The facts and circumstances of the non-compliance or suspected non-compliance.~~
- ~~• The nature and extent of the consequences or potential consequences to shareholders, creditors, employees and the wider public.~~

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

- The legal and regulatory framework.
- The appropriateness and timeliness of the response of the professional accountant's superior, if any, and those charged with governance.
- The urgency of the matter.
- The pervasiveness of the matter throughout the employing organization.
- ~~Whether the appropriateness of such response can be assessed.~~
- Whether the professional accountant continues to have confidence in the integrity of the professional accountant's superiors and those charged with governance.
- ~~Whether those charged with governance are independent of management.~~
- Whether the non-compliance or suspected non-compliance is likely to recur.
- ~~The likelihood of continuing consequences for shareholders, creditors, employees and the wider public.~~
- Whether there is credible evidence of actual or potential substantial harm to the interests of the employing organization, investors, creditors, employees or the wider public. An act

that causes substantial harm is one that results in immediate or ongoing serious adverse consequences to any of these parties in financial or non-financial terms.

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

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

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

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

360.23 Further action ~~will depend on the legal and regulatory framework and~~ may include ~~one or more of the following~~:

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

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

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

Determining Whether to Disclose the Matter to an Appropriate Authority

360.26 In determining whether to disclose the matter to an appropriate authority, relevant factors to consider include:

- The nature and extent of the actual or potential harm to the interests of the employing organization, investors, creditors, employees or the wider public. For example:

- o Whether the matter could threaten the employing organization's ability to operate.
- o If the employing organization is listed on a securities exchange, whether the matter could adversely impact the fair and orderly market in the employing organization's securities or pose a systemic risk to the financial markets.
- o Whether products that could be harmful to public health or safety would be likely to be sold by the employing organization.
- ~~Whether disclosure would be contrary to law or regulation.~~
- Whether there is an appropriate authority that can receive the information and cause the matter to be investigated.
- Whether there exists robust and credible protection from civil, criminal or professional liability or retaliation afforded by legislation or regulation, such as under whistle blowing legislation or regulation.
- Whether there are actual or potential threats to the physical safety of the professional accountant or other individuals.

~~Whether disclosure would be~~ precluded if it would be contrary to law or regulation.

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

360.28 If the professional accountant decides that disclosure of the matter to an appropriate authority would be an appropriate course of action in the circumstances, this would not be considered a breach of the duty of confidentiality under Section 140 of this Code. When making such disclosure, the professional accountant shall act in good faith and exercise caution when making statements and assertions.

Resigning from the Employing Organization

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

Responsibilities of Other Professional Accountants in Business

360.30 Paragraphs 360.31-34 apply to professional accountants in business other than those who meet the description of a senior professional accountant in business in paragraph 360.12 above.

360.31 If, in the course of carrying out employment responsibilities, a professional accountant becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws and regulations, the professional accountant shall seek to obtain an understanding of the matter, including:

- The nature of the act and the circumstances in which it has been or may be committed; and

- The application of the relevant laws and regulations to the circumstances.

360.32 The professional accountant is expected to apply knowledge, judgment and expertise, but is not expected to have detailed knowledge of laws and regulations beyond that which is required for ~~the professional activity~~ the professional accountant's role within the employing organization's undertaking. Whether an act constitutes actual non-compliance is ultimately a matter for legal determination by a court of law. Depending on the nature and significance of the matter, the professional accountant may consult on a confidential basis with others within the employing organization, a relevant professional body or legal counsel.

360.33 If the professional accountant suspects that non-compliance with laws and regulations has been or may be committed, the professional accountant shall, subject to paragraph 360.11, inform an immediate superior to enable the superior to take appropriate action. If the professional accountant's immediate superior appears to be involved in the matter, the professional accountant shall inform the next higher level of authority within the employing organization.

360.34 In exceptional circumstances, the professional accountant may decide that disclosure of the matter to an appropriate authority would be an appropriate course of action. If the professional accountant were to do so pursuant to paragraph 360.26, this would not be considered a breach of the duty of confidentiality under Section 140 of this Code. When making such disclosure, the professional accountant shall act in good faith and exercise caution when making statements and assertions.

Documentation

360.35 Regardless of the level of seniority of the professional accountant in business within the employing organization, where the professional accountant judges identified or suspected non-compliance with laws and regulations to be a significant matter, the professional accountant is encouraged to document: the nature and substance of the matter, the details of discussions held, and the decisions made concerning the matter, in particular if the matter could have significant consequences for the employing organization or others.

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

Documentation provides a number of benefits, including the following:

- It provides evidence of the professional accountant's judgments in forming conclusions.
- It may serve to protect the professional accountant if challenged in legal or disciplinary proceedings to justify the professional accountant's actions in responding to the matter.

Commented [KS53]: To respond to comments at January board meeting.

Commented [KS54]: To respond to comments at the January board meeting.

Commented [KS55]: Redrafted to be consistent with the documentation provision for PAs in public practice providing services other than audits.

Commented [KS56]: Moved to the broader Code as a consequential change to Section 100.

- ~~• It may assist the professional accountant if required to appear before a court of law or tribunal to provide testimony regarding the matter.~~

360.31 ~~When the matter is documented, it is important that the documentation is prepared in a careful and thoughtful manner and with appropriate diligence as it may be subject to legal discovery if the matter were to be dealt with in a court of law.~~

Commented [KS57]: Ditto.