

**Roundtable Briefing Note**  
**Prepared by the Staff of the IESBA**  
*May 2014*

*International Ethics Standards Board for  
Accountants*

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

**IESBA**

**International  
Ethics Standards  
Board for Accountants**

This document was prepared by the Staff of the International Ethics Standards Board for Accountants (IESBA).

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

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

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## ROUNDTABLE BRIEFING NOTE: RESPONDING TO NON-COMPLIANCE WITH LAWS AND REGULATIONS

### I. Introduction

1. A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. The IESBA *Code of Ethics for Professional Accountants* (the Code) provides ethical requirements and guidance to help professional accountants (PAs) to meet this responsibility.
2. Among other responsibilities, the Code requires the PA to comply with the fundamental principle of confidentiality. This means respecting the confidentiality of information acquired as a result of professional and business relationships and not disclosing any such information to third parties without proper and specific authority or unless there is a legal or professional duty or right to disclose.
3. In the course of providing a professional service to a client or carrying out professional activities for an employer, a PA may come across an instance of non-compliance with laws and regulations (NOCLAR) or suspected NOCLAR<sup>1</sup> committed or about to be committed by the client or the employer, or by those charged with governance, management or employees of the client or employer. Recognizing that such a situation can often be a difficult and stressful one for the PA, and accepting that the PA has a prima facie ethical responsibility not to turn a blind eye to the matter, the IESBA initiated this project to develop enhancements to the Code to help guide the PA in dealing with the situation and in deciding how best to serve the public interest in these circumstances.
4. In practice, such situations will often be resolved through the PA obtaining an understanding of the matter and discussing it with management, and if necessary escalating the issue to higher levels of management and those charged with governance (TCWG). In those circumstances, the public interest will best be served by maintaining confidentiality in line with the fundamental principle. In a few situations, however, the PA may come across a NOCLAR or suspected NOCLAR of such gravity that the public interest and the standing of the profession would be better served by overriding the principle of confidentiality in order to disclose the non-compliance to an appropriate authority (if the client or employer has not already made such disclosure), even where there is no specific legal or professional duty or right to disclose.

#### *Scope of the Proposals*

5. The 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 an employment relationship for PAs in business (PAIBs). The proposals would exclude circumstances where the PA has no direct relationship with the party suspected of committing an act contrary to prevailing laws or regulations, for example, where a PA has been engaged by a client to perform a due diligence assignment on a third party entity and the

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<sup>1</sup> Formerly called "suspected illegal act" in this project

suspected illegal act has been committed by that third party.

6. The proposals would also exclude personal misconduct unrelated to the business activities of the client or employer.

#### Relationship with ISAs 240 and 250<sup>2</sup>

7. The requirements in ISA 240 are designed to assist auditors in identifying and assessing the risks of material misstatement of the financial statements due to fraud and in designing procedures to detect such misstatement. The requirements in ISA 250 are designed to assist auditors in identifying material misstatement of the financial statements due to NOCLAR.
8. The proposed enhancements to the Code reflect the fact that in some instances of non-compliance, the impact on the financial statements may be uncertain but the matters are nonetheless of such gravity that their disclosure to an appropriate authority may nonetheless be in the public interest.<sup>3</sup>

#### *Exposure Draft and Further Consultation Through Roundtables*

9. In August 2012, the IESBA issued its exposure draft (ED), [\*Responding to a Suspected Illegal Act\*](#). Overall, there was general support for the IESBA to explore appropriate responses by PAs to NOCLARs or suspected NOCLARs in the public interest. Respondents from the regulatory community, in particular, were supportive of the IESBA's efforts to provide better guidance not just to auditors but also to PAs in public practice providing services to non-audit clients and PAIBs in considering appropriate responses to NOCLARs or suspected NOCLARs when carrying out their engagement or employment responsibilities.
10. However, there were significant concerns among respondents regarding the three main proposals in the ED, i.e.:
  - A requirement for a PA providing professional services to an audit client to disclose certain NOCLARs to an appropriate authority if the entity has not self-reported;
  - A requirement for a PA providing non-audit services to a client that is not an audit client and for a PAIB to disclose certain NOCLARs to the external auditor in specific circumstances; and
  - A right for a PA providing non-audit services to a client that is not an audit client and for a PAIB to disclose certain NOCLARs to an appropriate authority in specific circumstances and the expectation that such a right would be exercised.
11. In the light of these and other substantive concerns from respondents on the ED, the IESBA decided to hold a series of three global roundtables in Hong Kong SAR on May 20, 2014; Brussels, Belgium, on June 13, 2014; and Washington DC, USA, on July 10, 2014 to solicit further views and input from stakeholders on revised proposals which it tentatively agreed at its December 2013 meeting.

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<sup>2</sup> ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, and ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*

<sup>3</sup> Staff of both the IESBA and the International Auditing and Assurance Standards Board (IAASB) are liaising as this IESBA project evolves. The IAASB has not yet discussed whether changes, if any, to the ISAs would be necessary as a result of changes to the Code arising from this project.

*Purpose of this Briefing Note*

12. To facilitate participants' preparations for, and discussions at, the roundtables, this Briefing Note provides a high-level overview of respondents' significant concerns on the ED. It also outlines the IESBA's tentative revised proposals (particularly with respect to the proposed Sections 225<sup>4</sup> and 360<sup>5</sup> applicable to PAs in public practice and PAIBs, respectively), and explains how the IESBA reached its tentative decisions on the way forward on the key issues.
13. The IESBA's tentative revised proposals on Sections 225 and 360 are set out in Appendix 1. Related changes to other Sections of the Code (shown in mark-up from the ED) are included in Appendix 2. Flow charts outlining the process under Sections 225 and 360 are included in Appendix 3

**II. Overview of Respondents' Significant Concerns on the ED**

14. The comment period for the ED closed on December 15, 2012. Comment letters were received from 74 respondents. The high response rate together with the relatively broad range of respondents and the many thoughtful comments received on the ED demonstrate clearly the importance of, and significant interest in, the topic.
15. The table below shows broadly the balance of *overall* support for the main proposals in the ED.

Category of Respondent	Overall Support?			
	Yes	Part Support/ Concerns	No	Total
IFAC Member Bodies <sup>6</sup>	7	4	23	<b>34</b>
Firms			12	<b>12</b>
Regulators and Public Authorities	1	3	1	<b>5</b>
National Standard Setters			2	<b>2</b>
Other Professional organizations		4	15	<b>19</b>
Individuals & Others	1		1	<b>2</b>
<b>Total</b>	<b>9</b>	<b>11</b>	<b>54</b>	<b>74</b>

16. As is apparent from the relative weight of overall support above, the ED attracted a significant level of opposition across most of the main categories of respondents. Many respondents, in particular, felt that a requirement to disclose suspected NOCLAR to an appropriate authority is a matter that

<sup>4</sup> Proposed Section 225, *Responding to Non-Compliance with Laws and Regulations*

<sup>5</sup> Proposed Section 360, *Responding to Non-Compliance with Laws and Regulations*

<sup>6</sup> Certain IFAC Member Bodies also hold the dual role of ethics standard setter in their jurisdictions.

can only be properly addressed by legislators or regulators at the national level as only they, and not the Code, will be able to operationalize such a requirement in the context of the specific legal and regulatory frameworks of their jurisdictions.

17. The IESBA considered a comprehensive [summary of the significant comments](#) received on the ED at its March 2013 meeting.<sup>7</sup>
18. In January 2014, the IESBA commissioned an independent legal analysis of the ED responses. The legal analysis flagged a number of understandable concerns from respondents regarding the requirement to disclose suspected NOCLAR to an appropriate authority. These concerns centered around the following in particular:
  - The Code is unlikely, in most jurisdictions, to:
    - (a) Impose an obligation that overrides confidentiality obligations; or
    - (b) Otherwise provide protection from actions for breach of confidentiality;
  - General whistle-blowing legislation is unlikely to resolve the issue of lack of protection in many countries given that the nature of the protection is often limited;
  - While specific “whistle-blowing” legislation in terms of a duty on the PA to report, coupled with protection from reporting, may assist:
    - (a) Such legislation will not exist in all jurisdictions;
    - (b) It is unlikely to be sufficiently broad to cover all types of NOCLAR as originally envisaged; and
    - (c) It is very unlikely to cover all PAs; and
  - While public interest disclosure gateways may exist in some jurisdictions, it would be difficult to reconcile reliance on these with a broad scope of covered NOCLAR.
19. Also understandable were concerns regarding the scope for negligence actions both where the PA reports and where the PA fails to report. In the former case, the legal analysis highlighted respondents’ concerns about the PA’s potential liability 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, it highlighted respondents’ concerns about the PA’s potential liability for foreseeable losses suffered by the victim, with the failure to comply with the Code being used to support the negligence argument.
20. The legal analysis also noted as understandable a number of concerns from respondents about the potential adverse impact of a requirement to disclose on the PA’s relationship with an audit client. In particular, some respondents had argued that with a requirement the PA would effectively turn into a quasi-investigator/prosecutor in relation to all acts of non-compliance. Many respondents had also raised concerns about the potential “chilling” effect of a requirement on the free flow of information between the PA and the audit client.
21. The legal analysis also highlighted concerns from respondents that in some jurisdictions:
  - There would be the possibility of retaliatory action against the PA;

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<sup>7</sup> A summary of how the IESBA has addressed respondents’ significant comments on the ED will be provided in the explanatory memorandum accompanying the revised proposals when these are issued for public comment.

- There will be difficulties in identifying who the appropriate authority might be; and
  - It will be fruitless to impose an obligation to disclose if it is known that the authority will not act.
22. Finally, the legal analysis flagged a number of understandable concerns from respondents from a practical standpoint, in particular:
- Would the PA have the expertise or experience to determine whether the act in question is an act of non-compliance with law or regulation?
  - What level of information would confirm or dispel a suspicion?
  - How would the PA address limits on access to information?
  - What if the information comes to the PA's attention at the end of the engagement?
  - How would the PA's actions interact with legislation prohibiting tipping-off, if applicable?
  - What would be the time and cost implications of the need for further work to follow up on suspected NOCLAR?

### III. Tentative Revised IESBA Proposals

#### A. Alternative Approach to Proposed Section 225 – PAs in Public Practice

23. Having considered the concerns expressed by respondents to the ED, the IESBA believes that the public interest could be better served by an alternative approach. The IESBA has therefore reconsidered Section 225 and proposes the revised approach outlined below.
24. Given the greater support among respondents for not distinguishing responsibilities between PAs providing professional services to audit clients and PAs providing professional services to non-audit clients, the IESBA proposes that Section 225 not make that distinction. Instead, the IESBA proposes that Section 225:
- (a) Establish the responsibilities that should apply to both categories of PAs; and
  - (b) Only provide specific guidance where a distinction truly needs to be made (for example, see paragraphs 225.15-17, Appendix 1).<sup>8</sup>
25. The IESBA has then restructured the guidance as follows with a focus on assisting the PA in dealing with the difficult, and often stressful, situation that arises when the PA encounters a suspected NOCLAR:
- (a) Recognizing *a priori* that the responsibility for complying with laws and regulations rests first and foremost with the client or its management and TCWG. This responsibility includes addressing any NOCLAR by the client or by TCWG, management or employees of the client (see paragraph 225.3). The IESBA believes that making this fact clear would be responsive to the many respondents to the ED who argued that addressing a suspected NOCLAR should be the overriding duty of management, including consideration of whether the matter may need disclosure to an appropriate authority. This is also broadly consistent with the approach taken in ISA 250;

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<sup>8</sup> References to paragraph numbers hereafter are to the clean version of proposed Section 225 in Appendix 1, unless otherwise stated.

- (b) As in the ED, making it clear that when the PA encounters a suspected NOCLAR, the PA's first responsibility should be to comply with any laws or regulations that govern how a matter should be addressed (see paragraph 225.4);
- (c) Laying out the appropriate requirements and guidance regarding:
  - (i) Obtaining an understanding of the matter where it is other than clearly inconsequential (paragraphs 225.5-13) (the issue of materiality thresholds is discussed in Section D below);
  - (ii) Evaluating the response of the client if the matter could have significant consequences for the client or others (paragraphs 225.14-18) (the issue of materiality thresholds is discussed in Section D below); and
  - (iii) Disclosing the matter to an appropriate authority (paragraphs 225.19-24); and
- (d) Dealing with documentation (paragraphs 225.25-26).

*Obtaining an Understanding of the Matter*

26. The IESBA proposes that Section 225 move away from what many respondents perceived to be an overly prescriptive approach in the ED to one that is couched more in terms of how the Code may help the PA deal with the situation. Accordingly, in the "understanding the matter" phase, rather than focusing on confirming or dispelling a suspicion, the revised approach articulates the PA's responsibilities and options in terms of:
- Seeking to obtain an understanding of the matter, including the application of the relevant laws and regulations to the circumstances, the gravity of the matter and its potential consequences (paragraph 225.5);
  - Explaining that the PA may, subject to the nature and gravity of the matter, consult with others within the firm, a network firm, a relevant professional body or legal counsel (paragraph 225.6);
  - Explaining that for a PA performing a non-audit service for a non-audit client, the matter may not necessarily be within the PA's expertise. Nevertheless, the closer the matter is to the PA's expertise, the greater the duty for the PA to pursue the matter with the client (paragraph 225.7);
  - Explaining why a PA performing a non-audit service for an audit client of the firm or network firm should discuss the matter with the engagement partner for the audit (paragraph 225.8);
  - Explaining why the PA should communicate with the client regarding the matter (paragraph 225.9);
  - Explaining what courses of action are available where:
    - The PA suspects that management or TCWG are involved in the non-compliance (paragraph 225.11); or
    - The PA is unsure as to the person to whom to report or insufficient information is obtained to satisfy the PA that the client is in compliance with laws and regulations (paragraph 225.12).
  - Given the PA's role as a trusted advisor to the client, assessing whether the client or its management or TCWG understand their legal or regulatory responsibilities to address the

matter and, if not, considering recommending that they obtain legal advice (paragraph 225.13); and

*Evaluating the Response of the Client*

27. The IESBA does not believe that the PA's responsibility should end at the point of communicating the matter with the client or its management or TCWG given that certain instances of non-compliance may have serious consequences for the client, its stakeholders and the public. Accordingly, the IESBA proposes that an explicit requirement be established for the PA to evaluate whether the client, its management or TCWG have appropriately addressed the matter (paragraph 225.14).
28. The IESBA then proposes guidance to:
  - Assist the PA in making such an evaluation (paragraphs 225.14-15); and
  - Lay out possible courses of action if the PA judges that the response of the client is not appropriate or the PA is unable to assess whether the response is appropriate (paragraphs 225.16-17).
29. In the event that the PA believes that the client still has not appropriately addressed the matter, or if the PA is unable to assess whether the response is appropriate, the IESBA then proposes that the PA determine whether to disclose the matter to an appropriate authority (assuming the client has not already made adequate disclosure to an appropriate authority) (paragraph 225.18). Section B below discusses this further.

**B. Disclosure of NOCLAR to an Appropriate Authority**

30. In determining what should be the appropriate standard with respect to disclosure of a suspected NOCLAR to an appropriate authority, the IESBA initially considered, in response to the feedback on the ED, three options focused on the audit of a public interest entity (PIE) where the legal framework affords protection for disclosure:
    - (a) A requirement;
    - (b) An expectation; or
    - (c) A rebuttable presumption.
  31. Each of those options would be subject to the following further conditions:
    - (a) The matter has a material impact on the financial statements and the financial statements have not been adjusted to reflect that impact;
    - (b) There is an appropriate authority to receive the information; and
    - (c) The client has not already adequately disclosed the matter to the appropriate authority.
- (a) *Requirement to Disclose*
32. The IESBA felt that an outright requirement, even in the limited circumstances circumscribed by the above conditions, would face several of the same significant concerns respondents had raised on the ED. Chief among those is the argument that a disclosure requirement is a matter that can only be properly addressed by legislators or regulators at the national level as only they, and not the Code, will be able to operationalize such a requirement in the context of the specific legal and

regulatory frameworks of their jurisdictions.

(b) *Expectation of Disclosure*

33. The IESBA also felt that the option of an expectation, coupled with a permission to override confidentiality under the Code, could give rise to the same question that was raised by a number of respondents to the ED as to whether this would mean a de facto requirement to disclose. In particular, an expectation might be thought to create a moral obligation on the PA, such that if the PA does not disclose the PA would be falling short of the standard of professional conduct expected by the Code. To this extent, the PA might even be thought to be in breach of the Code.

(c) *Rebuttable Presumption of Disclosure*

34. The IESBA also did not support this option because of concerns as to whether it could be operationalized in a global Code, even under the defined limited circumstances. Among those concerns were views that a rebuttable presumption would amount to a de facto requirement in practical terms (a view also expressed at the IESBA Consultative Advisory Group (CAG)). In addition, the IESBA felt that whether this approach would be workable would depend on the existence of a fair and trusted legal process and one that was accustomed to dealing with the rebuttable presumption concept.

*Proposed Way Forward*

35. After due deliberation of the feedback to the ED, the IESBA agreed that the real issue is not about whether disclosure to an appropriate authority would be justified if doing so would be in the public interest, but about *compelling* the PA to do so. The IESBA believes that establishing a requirement or presumption in the Code would presuppose the existence of a legal framework and process accustomed to dealing with a requirement or rebuttable presumption regarding disclosure, and not merely the availability of sufficiently established legal protection from civil or criminal liability. Given the wide variation in legal frameworks around the world and in the degree to which they are developed, the IESBA felt that it would be inappropriate and unreasonable for a Code for global application to (a) establish a requirement or presumption of disclosure based on such presupposition, and (b) compel the PA to take a leap of faith that the legal process will be sufficiently robust to deal with any adverse consequences for the PA or indeed make the PA whole given the potential costs of disclosure.
36. The IESBA believes that it is, and should be, within the proper authority, purview and power of national legislators or regulators to establish a disclosure obligation for PAs. This in fact is already the case in a number of jurisdictions around the world that mandate disclosure by PAs, for example, in the context of audits of financial statements. Further, in the context of the responses to the ED and the IESBA's further discussions with regulators and audit oversight bodies, the regulatory community *as a whole* has not argued, nor made a case, that the Code must impose a disclosure obligation on PAs in the circumstances envisaged.
37. The IESBA therefore came to the tentative view that it would not be appropriate to pursue any of the above three options. Instead, the IESBA proposes the following revised approach:
- First recognizing that if there already are legal or regulatory provisions in place governing the reporting of non-compliance, the PA must comply with those provisions (paragraph 225.19).

- Where there are no such legal or regulatory provisions, referring to the profession's acceptance of its responsibility to act in the public interest to set the appropriate tone and context for the PA's decision as to whether or not to disclose the matter to an appropriate authority (paragraph 225.20).
  - Requiring the PA to consider the gravity of the matter and whether nevertheless to disclose the matter in order to serve the public interest, provided that such disclosure would not be contrary to law or regulation (paragraph 225.20).
  - Providing guidance regarding the PA's consideration of the gravity of the matter in terms of the likely consequences (financial and non-financial) to those potentially affected by the matter. As an illustration of what is intended, the IESBA proposes guidance to explain that an auditor of a listed entity would take into account the consequences to the investing public (paragraph 225.20). See further discussion in section C below.
  - To assist the PA in deciding whether to disclose in the circumstances, highlighting the need to take into account the degree to which relevant information is known and substantiated, and whether there is an appropriate authority to receive the information. In this regard, the IESBA proposes to revise the description of an appropriate authority in terms of one that has acknowledged that it can receive the information and cause the matter to be investigated (paragraph 225.21).
  - Recognizing further that the existence of whistle-blowing protection from civil or criminal liability may be a factor to consider in deciding whether to disclose (paragraph 225.21).
  - Encouraging the PA to seek legal advice to understand the legal implications of disclosure to an appropriate authority (paragraph 225.22).
  - Making it clear that if the PA then decides to disclose in such a situation (assuming such disclosure would not be prohibited by law or regulation), this would not be a breach of the duty of confidentiality under the Code (paragraph 225.23).
  - Finally, reminding the PA that withdrawal from the engagement and the professional relationship may also be considered where permitted by law or regulation (paragraph 225.24).
38. The IESBA believes that this approach is a practicable way forward and, together with the proposal that the Code mandate communication between successor and predecessor auditors in the case of audits of financial statements (see section E below), would raise the bar significantly relative to where the Code stands today. The IESBA believes that it is incumbent upon legislators and regulators, as the principal guardians of the public interest, to take action to put in place the necessary legal and regulatory framework and process at the national level to support the disclosure by PAs of non-compliance to an appropriate authority.

### C. **Types of NOCLAR to be Disclosed**

39. The ED proposed that the following types of suspected NOCLAR be disclosed:
- For a PA in public practice providing services to an audit client:
    - Suspected NOCLARs that directly or indirectly affect the client's financial reporting; and
    - Suspected 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:
  - Suspected NOCLARs that relate to the subject matter of the professional services being provided by the PA. (This recognized the limited scope of the engagements in these circumstances.)
- For a PAIB:
  - Suspected NOCLARs that directly or indirectly affect the employing organization's financial reporting; and
  - Suspected NOCLARs the subject matter of which falls within the PA's expertise.

*PAAs in Public Practice Providing Services to an Audit Client*

40. A majority of the respondents who commented on this proposal did not support the proposed types of suspected NOCLARs to be disclosed for PAs providing services to an audit client. Several felt that any restriction is inconsistent with the public interest argument used to justify a requirement or right to disclose, or would be inappropriate in a code dealing with "ethics." A few were of the view that the types of suspected NOCLARs to be disclosed should be determined by national authorities. A few others favored limiting the types of suspected NOCLARs to be disclosed to only matters that materially affect financial reporting.

*PAAs in Public Practice Providing Services to a Non-Audit Client, and PAIBs*

41. A majority of the respondents who commented on the proposals for PAs providing services to a non-audit client and for PAIBs did not support these proposals. Several of them felt that there should be no limitation in scope, especially if a public interest rationale was used to justify disclosure.

*Tentative Revised IESBA Proposal*

42. In the light of respondents' views above, the IESBA came to the view that placing limitations on the types of NOCLARs to be disclosed as originally proposed would not be appropriate if PAs are to uphold their responsibility to act in the public interest.
43. Accordingly, the IESBA proposes that the various filters in the ED as to the types of NOCLAR that may be disclosed be removed. While it made sense to limit matters to disclose to the PA's expertise when there was a requirement in order to avoid placing an undue burden on the PA to report matters outside the PA's expertise, the IESBA believes that in the absence of a requirement the PA should be free to disclose matters that are also outside the PA's expertise.
44. The circumstances in which the IESBA envisages such disclosure to be appropriate are likely to involve a significant risk that the matter would lead to, for example, serious harm to the health or safety of individuals, significant damage to the environment, or significant financial losses to shareholders, customers, suppliers or counterparties.

**D. Appropriate Authority**

45. 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.

46. 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.
47. 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 the disclosures. Some respondents also noted that not all countries may have an appropriate authority, particularly if reporting is not mandated in law.
48. Acknowledging these concerns, the IESBA proposes that the description of an appropriate authority be revised as follows to make clear that such an authority is one that has acknowledged that it can receive such information and cause the matter to be investigated (paragraph 225.21):

An appropriate authority is one that has acknowledged that it can receive such information and cause the matter to be investigated. The appropriate authority to which to disclose the matter will depend on the nature of the matter, for example, a securities regulator in the case of fraudulent financial reporting or tax authorities in the case of tax evasion.

#### E. **Materiality Thresholds**

49. Respondents to the ED as well as some on the IESBA CAG have questioned whether the ED had specified the appropriate threshold for disclosure of certain suspected NOCLARs to an appropriate authority, as they perceived the same threshold to apply to both the investigation and disclosure phases. Equally, in debating the appropriateness of the option of a rebuttable presumption of disclosure, some on the IESBA noted that the test of materiality to which the presumption was subject came late in the process and it should rather come earlier to avoid the PA having to put every matter that is other than clearly inconsequential through the process of investigation and resolution.
50. The IESBA first agreed that as a matter of *ethical principle*, every identified or suspected non-compliance should be a matter of concern for the PA regardless of the significance or potential impact of the non-compliance. The IESBA, however, recognized that the Code is a body of standards for practical application and it would not serve the public interest if the Code were impracticable to apply. Accordingly, the IESBA agreed that it would be appropriate to introduce a materiality threshold at the front end of the process, albeit that this would not necessarily be intended to indicate that any identified or suspected non-compliance that passes this threshold will be material to the financial statements.
51. The IESBA proposes that this be done at the following two stages:
  - At the point when the PA becomes aware of information concerning non-compliance or suspected non-compliance, the PA should seek to obtain an understanding of such a matter as long as it is *other than clearly inconsequential* (paragraph 225.5). At this point in the process, the PA will generally have only a limited amount of information concerning the matter and it is only appropriate that the scope be fairly wide in terms of seeking an understanding of the nature and implications of such a matter.

- At the point of understanding what actions the client, its management or TCWG plan to take to address the matter and then evaluating their response, the IESBA felt that the PA's efforts should more narrowly focus on matters that could have *significant consequences for the client or others* (paragraphs 225.9(b) and 225.14). At that stage of the process, after having discussed the matter with the client to confirm the PA's understanding of the facts and circumstances and the potential consequences, the PA should have an appreciation of whether or not the matter could have significant consequences for the client or others. It will be a matter of the PA's professional judgment as to whether a particular matter could have significant consequences in this regard.

52. Thereafter in the process through to consideration of whether to report to an appropriate authority, the PA's efforts will focus only on matters that could have significant consequences for the client or others. The IESBA believes this approach gives due regard to proportionality of work effort and costs of implementation.

#### F. **Communication Between Successor and Predecessor Auditors**

53. Section 210 of the Code currently suggests as a safeguard that when considering taking up a new appointment with a prospective client, a PA ask the existing PA to provide known information on any facts or circumstances that, in the existing PA's opinion, the proposed PA needs to be aware of before deciding whether to accept the engagement.<sup>9</sup>

54. During the Board deliberations, several IESBA members emphasized the importance of communication between the successor and predecessor auditors in the case of audits of financial statements. It was recognized that it would not be in the public interest if a matter of non-compliance were to be simply dropped as a result of the withdrawal of the existing auditor from the client relationship without a potential successor being alerted to it. This issue was also flagged by the IESBA CAG. In addition, a regulatory respondent to the ED had recommended that the IESBA consider requiring the predecessor auditor to notify a successor auditor of the non-compliance, prior to the latter's final acceptance of the engagement, so that the successor auditor understands the risk of accepting the engagement.

55. The IESBA recognizes the potential benefits that may flow from the Code mandating communication between successor and predecessor auditors. 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 non-compliance, or deterring the commission of non-compliance, than what might otherwise be achieved in the Code. The IESBA also considered existing practice in Canada and the UK where the national ethical requirements in this area are more demanding. Canada, in particular, already has a requirement with respect to communication between successor and predecessor auditors and a further related requirement regarding sharing by a predecessor auditor of information concerning suspected fraud or other illegal activity with a possible successor auditor.<sup>10</sup>

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<sup>9</sup> Section 210, *Professional Appointment*, paragraph 11

<sup>10</sup> Canadian Rule of Professional Conduct 302, *Communication with Predecessor*

.1 A member shall not accept an engagement with respect to the practice of public accounting or the public practice of a function not inconsistent with public accounting, where the member is replacing another member or public accountant, without first communicating with such person and inquiring whether there are any circumstances the member should take into account which might influence the member's decision whether or not to accept the engagement.

56. The IESBA therefore proposes that Section 210 be amended as follows:
- Requiring in the case of an audit of financial statements that a proposed PA request the existing PA to provide known information regarding any facts or circumstances that, in the existing PA's opinion, the proposed PA needs to be aware of before deciding whether to accept the engagement (paragraph 210.13, Appendix 2).
  - If the client consents to the existing accountant disclosing any such facts or circumstances to the proposed accountant, requiring the existing accountant to provide the information honestly and unambiguously (paragraph 210.13, Appendix 2).
  - If the client fails or refuses to grant the existing PA permission to discuss the client's affairs with the proposed PA, requiring the existing PA to disclose this fact to the proposed PA; and requiring the proposed PA to then carefully consider such failure or refusal when determining whether or not to accept the appointment (paragraph 210.13, Appendix 2).
  - Making a consequential change in Section 210 to delete the indication in the current Code 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 of appointment (paragraph 210.9, Appendix 2).
57. These proposed requirements will, importantly, need to operate within the constraints of client consent and the specific requirements of the legal, regulatory and ethical framework in the particular jurisdiction. Accordingly, the IESBA proposes retaining the current provisions in Section 210 to the effect that whether the existing PA is able to discuss the client's affairs with the proposed PA is subject to client consent and the prevailing national legal or ethical requirements regarding such communication and disclosure (paragraphs 210.11-12, Appendix 2).
58. With respect to the scope of the proposed communication requirement, the IESBA felt that it would be appropriate to limit the requirement to audits of financial statements given the greater public interest role of auditors. Therefore, in all other cases, the IESBA proposes that communication with an existing PA continue to be a possible safeguard, subject to the relevant facts and circumstances (paragraph 210.9, Appendix 2).
59. By complementing the provisions in the proposed Section 225, the IESBA believes that the proposed requirement would serve to raise the bar in the Code in a practicable way for auditors in responding to non-compliance by clients. The proposal is also responsive to a recommendation that arose from the IAASB's Audit Quality project for the IESBA to consider improving information sharing between audit firms when one firm decides to resign from, or is not reappointed to, an audit engagement. Further, the proposal would complement the ISAs given that ISA 300 already requires a successor auditor to communicate with a predecessor auditor in compliance with relevant ethical requirements.<sup>11</sup>

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.2 The incumbent member shall respond promptly to the communication referred to in Rule 302.1.

.3 A member responding to a communication pursuant to Rule 302.2 shall inform the possible successor if suspected fraud or other illegal activity by the client was a factor in the member's resignation or if, in the member's view, fraud or other illegal activity by the client may have been a factor in the client's decision to appoint a successor.

<sup>11</sup> ISA 300, *Planning an Audit of Financial Statements*, paragraph 13

**G. Documentation**

60. The ED proposed to require the PA to document 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.
61. Views on this proposal were divided. Many respondents were supportive of the requirements as proposed, with a few suggesting that further guidance be provided to facilitate proportionate application and to avoid PAs inadvertently prejudicing the legal process.
62. Many others, however, were opposed to the proposal. In particular, several of them were concerned that:
  - The requirements would be disproportionate as they seemed to call for documentation regardless of whether the suspected NOCLARs were of any consequence; and
  - The resulting documentation may be legally discoverable.
63. 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.

*Tentative Revised IESBA Proposal*

64. In the light of the significant concerns expressed by respondents to the ED regarding the documentation proposal, the IESBA proposes that the requirement be replaced with an encouragement for the PA to document the nature and substance of the matter, the discussions held and the decisions made concerning the matter. In addition, the IESBA proposes further guidance to:
  - (a) Explain why documentation would be helpful to the PA; and
  - (b) Highlight the importance of careful and thoughtful documentation given that any documentation the PA prepares can be subject to legal discovery (paragraph 225.25-26).

**H. Proposed Section 360 – PAIBs**

65. The IESBA has generally conformed Section 360 to the changes proposed in Section 225 but with a greater emphasis on providing guidance to the PAIB. Accordingly, there is a lesser degree of prescription with respect to specific actions the PAIB should take or consider in responding to non-compliance.

*Consideration of the Employing Organization's Ethics Policy*

66. In response to feedback on the ED, the IESBA also agreed to address more clearly the interaction between a consideration of any internal ethics policy within the employing organization and a consideration of whether to raise the suspected NOCLAR within the PA's reporting lines. Therefore, as part of the Understanding the Matter phase, the IESBA proposes that the PAIB be guided to consider the protocols and procedures, if any, that the employing organization may have established to address such a matter (paragraph 360.7).

67. The IESBA believes that if after gathering the relevant information the PAIB identifies or suspects a NOCLAR, he or she should generally *first* address the matter within the reporting lines of the employing organization by discussing the matter with his or her immediate superior or higher levels of management as appropriate (paragraph 360.8). The IESBA, however, proposes to make clear that in certain circumstances, the PAIB may deem it more appropriate to communicate the matter in accordance with the protocols established by the employing organization's ethics policy where such protocols provide for anonymity. This may be the case, for example, when the PAIB is employed in a relatively junior position and believes that the non-compliance is deliberate and involves different layers of management (paragraph 360.11).

*Position of the PAIB in the Employing Organization's Hierarchy*

68. Also in response to feedback on the ED, the IESBA agreed that the revised proposals should include guidance to acknowledge that the PAIB's position in the employing organization's hierarchy may influence his or her ability to evaluate the response of his or her immediate superior, management or TCWG to the matter. In this regard, the revised proposals recognize that the higher the PAIB's position with the employing organization, the greater his or her access to information and higher levels of management (paragraph 360.13).

*Consideration of the Public Interest for PAIBs*

69. In deliberating the matter of disclosure of a suspected NOCLAR to an appropriate authority for PAIBs, the IESBA weighed whether or not a PAIB's judgment as to whether to do so should include consideration of the public interest. One side of the argument was that it would be unreasonable for the Code to expect an individual PAIB alone to be able to consider such public interest. The other side was that such a consideration is an implicit part of the evaluation of the gravity of the matter. In this regard, it was recognized that a PA in public practice may face the same challenges in weighing the public interest as a PAIB. Also, it was observed that specifying a differential approach may convey the impression that there is a different meaning of the public interest for PAIBs. In addition, it was noted that all PAs already have a responsibility to act in the public interest under the Code.
70. Therefore, after due reflection the IESBA supported making consideration of the public interest consistent for both PAs in public practice and in business.

**I. Other Proposed Changes**

*Permission to Override Confidentiality*

71. To complement the proposed approach to disclosure of a suspected NOCLAR to an appropriate authority, the IESBA proposes that the Code establish in Section 140<sup>12</sup> that a PA is permitted to override the duty of confidentiality under the Code when disclosing identified or suspected NOCLARs to an appropriate authority in the circumstances described in Sections 225 and 360 (paragraph 140.10(d), Appendix 2).
72. The IESBA felt it important to place this permission in the context of the essential role of confidentiality as a fundamental principle, i.e., that confidentiality serves the public interest because it facilitates the free flow of information between the PA and the PA's client or employer (paragraph 140.7, Appendix 2). The IESBA believes that incorporating such a statement in Section 140 sets

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<sup>12</sup> Section 140, *Confidentiality*

the appropriate tone for the permission that the Code then grants for the PA to override confidentiality under the Code in the identified circumstances, provided that such disclosure would not be prohibited by law or regulation.

*Ethical Obligation to Respond to a Suspected NOCLAR*

73. During its deliberations, the IESBA reaffirmed its view that a PA has an ethical obligation to respond to a suspected NOCLAR and not turn a blind eye to it, given the potential for certain suspected NOCLARs to have serious consequences for the public. Given the importance of this principle, the IESBA believes that it should be anchored within the Code's fundamental principles. In this regard, the IESBA believes the most appropriate fundamental principle that would support and stimulate this conduct is professional behavior. The IESBA is of the view that willfully ignoring a suspected NOCLAR would be tantamount to not living up to the public's high expectation of the profession to act in the public interest, and therefore represent conduct that would discredit the profession.
74. Accordingly, the IESBA proposes that Section 150<sup>13</sup> be amended to make clear that conduct that may adversely affect the good reputation of the profession includes not responding to circumstances where a PA has identified or suspects non-compliance by a client or employer (paragraph 150.1, Appendix 2). The IESBA also believes that an amendment to the definition of professional behavior in Section 100<sup>14</sup> would be necessary to make clear that the fundamental principle is about avoiding in the broadest sense conduct, as opposed to mere action, that discredits the profession (see paragraph 100.5, Appendix 2).

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<sup>13</sup> Section 150, *Professional Behavior*

<sup>14</sup> Section 100, *Introduction and Fundamental Principles*

## PROPOSED SECTIONS 225 AND 360 (DECEMBER 2013 – CLEAN VERSION)

### PROPOSED SECTION 225

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

- 225.1 This section addresses the responsibilities of a professional accountant in public practice when the professional accountant identifies or suspects that non-compliance with laws and regulations by a client has occurred or may be about to occur.
- 225.2 For the purposes of this section, non-compliance 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, for example, fraud. Personal misconduct unrelated to the business activities of the client is excluded. Whether an act constitutes non-compliance with laws and regulations is ultimately a matter for legal determination by a court of law.

#### *Responsibilities of the Client or Its Management*

- 225.3 It is the responsibility of the client or its 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 the client, its management and those charged with governance to 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 in Public Practice*

- 225.4 In some jurisdictions, there are legal or regulatory provisions governing how identified or suspected non-compliance with laws and regulations is to be addressed. If so, the professional accountant shall comply with those provisions, including with respect to 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

- 225.5 If a professional accountant performing a professional service becomes aware of information concerning non-compliance or suspected non-compliance with laws and regulations by the client and the matter is other than clearly inconsequential, the professional accountant shall seek to obtain an understanding of the matter, including:
- The application of the relevant laws and regulations to the circumstances;
  - The gravity of the matter; and
  - The potential consequences to the client or others, including the impact on the client's financial reporting.
- 225.6 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. Depending on the nature

and gravity of the matter, the professional accountant may consult with others within the firm, a network firm, a relevant professional body, or legal counsel.

- 225.7 With respect to a professional accountant performing a non-audit service for a non-audit client, the professional accountant may have become aware of the matter during the course of the engagement, but it may not necessarily be within the professional accountant's expertise. The closer the matter is to the professional accountant's expertise, the greater the duty for the professional accountant to pursue the matter with the client.
- 225.8 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 discuss the matter with the engagement partner for the audit. This is to enable the audit engagement team to be made appropriately aware of the matter and for a determination to be made as to how the matter should be addressed in accordance with the provisions of this section.
- 225.9 If the professional accountant identifies or suspects non-compliance with laws and regulations, the professional accountant shall discuss the matter with the client to:
- (a) Confirm the professional accountant's understanding of the facts and circumstances relevant to the matter, and the potential consequences of the matter; and
  - (b) If the matter could have significant consequences for the client or others, understand what actions the client, its management or those charged with governance plan to take to address it, including whether they plan to disclose it to an appropriate authority.
- 225.10 The professional accountant shall undertake such discussions with the appropriate level of management and, where appropriate, those charged with governance. The determination of which level of management is the appropriate level with whom to discuss the identified or suspected non-compliance with laws and regulations is a question of professional judgment. Relevant factors to consider include:
- The nature of the matter.
  - The circumstances and individuals involved.
  - The likelihood of collusion.
  - The gravity of the matter.
  - Whether that level of management is able to take action to investigate the matter and take remedial action.
- 225.11 The appropriate level of management is generally at least one level above the person or persons who appear to be involved in the matter. In the context of an audit engagement, if the professional accountant suspects that management or those charged with governance are involved in the non-compliance, the professional accountant shall discuss the matter with the next higher level of authority at the entity, if it exists, such as an audit committee or supervisory board. The professional accountant may also consider discussing the matter with internal auditors, where applicable. In the context of a group audit engagement, the appropriate level may be management at an entity that controls the client.
- 225.12 Where no higher level of authority exists or if the professional accountant is unsure as to the person to whom to report or insufficient information is obtained to satisfy the professional accountant that the client is in compliance with laws and regulations, the professional accountant

is encouraged to obtain legal advice to understand what the possible or alternative courses of action might be.

- 225.13 The professional accountant shall assess whether the client, its management or those charged with governance understand their legal or regulatory responsibilities with respect to the matter and, if not, may recommend that they obtain legal advice.

#### Evaluating the Response of the Client

- 225.14 If the matter could have significant consequences for the client or others, the professional accountant shall evaluate whether the client, its management or those charged with governance have appropriately addressed it. In so doing, the professional accountant shall consider the nature and gravity of the matter and factors such as whether:

- The matter has been adequately investigated.
- Action has been taken to remediate the matter.
- Appropriate steps have been taken to reduce the risk of re-occurrence, for example, additional controls or training.
- The matter has been disclosed to an appropriate authority where appropriate and, if so, whether the disclosure appears adequate.

- 225.15 The degree to which the professional accountant is able to evaluate the response of the client, its management or those charged with governance may vary with the nature of the professional services provided to the client. In particular, if the client is an audit client, the professional accountant generally has greater access to information and management, by law or otherwise, than if the client is not an audit client.

- 225.16 If the client is an audit client and, in the professional accountant's judgment, the response of the client is not appropriate or the professional accountant is unable to assess whether the response is appropriate, the professional accountant shall:

- (a) Inform those charged with governance; and
- (b) Consider the professional accountant's reporting responsibilities under auditing standards.

The professional accountant may also consider consulting with a relevant professional body or seeking legal advice to understand the professional accountant's options and the professional or legal implications of taking any particular course of action.

- 225.17 If the client is not an audit client and, in the professional accountant's judgment, the response of the client is not appropriate or the professional accountant is unable to assess whether the response is appropriate, the professional accountant shall consider:

- (a) Informing those charged with governance;
- (b) Alerting the external auditor, if any, to the matter to enable the external auditor to determine whether specific action is needed in the context of the audit; or
- (c) Seeking advice from the professional accountant's professional body or seeking legal advice to understand the professional accountant's options and the professional or legal implications of taking any particular course of action.

225.18 If, in the professional accountant's opinion, the client has not appropriately addressed the matter or if the professional accountant is unable to assess whether the response is appropriate, the professional accountant shall determine whether to disclose the matter to an appropriate authority in accordance with paragraphs 225.19-225.24.

#### Disclosure of Non-Compliance with Laws and Regulations to an Appropriate Authority

225.19 Where there are legal or regulatory provisions governing the reporting of non-compliance to an appropriate authority, the professional accountant shall comply with such provisions.

225.20 A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. Accordingly, where there are no legal or regulatory provisions governing the reporting of non-compliance, the professional accountant shall consider the gravity of the matter and whether nevertheless to disclose the matter to an appropriate authority, provided that such disclosure would not be contrary to law or regulation. The gravity of the matter depends on the likely consequences to those potentially affected by the matter in both financial and non-financial terms, including the nature and extent of any damage to the wider public. For example, a professional accountant acting as an auditor of a listed entity would take into account the consequences to the investing public.

225.21 In considering whether to disclose, the professional accountant shall take into account the following:

- The degree to which the relevant information is known and substantiated.
- Whether there is an appropriate authority to receive the information. An appropriate authority is one that has acknowledged that it can receive such information and cause the matter to be investigated. The appropriate authority to which to disclose the matter will depend on the nature of the matter, for example, a securities regulator in the case of fraudulent financial reporting or tax authorities in the case of tax evasion.

The existence of protection from civil or criminal liability or retaliation afforded by legislation or regulation, such as under whistle-blowing legislation or regulation, also may be a factor to consider.

225.22 The professional accountant is encouraged to seek legal advice to understand the legal implications of disclosure to an appropriate authority.

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

225.24 The professional accountant may also consider withdrawing from the engagement and the professional relationship where permitted by law or regulation. Withdrawal, however, is not a substitute for complying with this section.

#### *Documentation*

225.25 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. 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.

225.26 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.

## PROPOSED SECTION 360

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

- 360.1 This section addresses the responsibilities of a professional accountant in business when the professional accountant identifies or suspects that non-compliance with laws or regulations by the professional accountant's employing organization has occurred or may be about to occur.
- 360.2 For the purposes of this section, non-compliance comprises acts of omission or commission, intentional or unintentional, committed by an employing organization, or by those charged with governance, management or employees of an employing organization which are contrary to the prevailing laws or regulations, for example, fraud. Personal misconduct unrelated to the business activities of the employing organization is excluded. Whether an act constitutes non-compliance with laws and regulations is ultimately a matter for legal determination by a court of law.

#### *Responsibilities of the Employing Organization and Its Management*

- 360.3 It is the responsibility of the employing organization and its 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 the employing organization, its management and those charged with governance to 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*

- 360.4 In some jurisdictions, there are legal or regulatory provisions governing how identified or suspected non-compliance with laws and regulations is to be addressed. If so, the professional accountant shall comply with those provisions.

#### Obtaining an Understanding of the Matter

- 360.5 If in the course of carrying out employment responsibilities a professional accountant becomes aware of information concerning non-compliance or suspected non-compliance with laws and regulations by the employing organization and the matter is other than clearly inconsequential, the professional accountant shall seek to obtain an understanding of the matter, including:
- The application of the relevant laws and regulations to the circumstances;
  - The gravity of the matter; and
  - The potential consequences to the employing organization or others.
- 360.6 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 is undertaking. Depending on the nature and gravity of the matter, the professional accountant may consult with a relevant professional body or legal counsel. While the professional accountant may have become aware of the matter when carrying out the professional accountant's employment responsibilities, it may not necessarily be within the professional accountant's expertise. The closer the matter is to the professional accountant's expertise, the greater the duty for the professional accountant to pursue the matter with the employer.

- 360.7 Many employing organizations have established protocols and procedures (for example, an ethics policy) regarding how potential non-compliance with laws and regulations by the employing organization should be addressed internally. If such protocols and procedures exist within the professional accountant's employing organization, the professional accountant may consider them in determining how to respond to the matter.
- 360.8 If the professional accountant identifies or suspects non-compliance with laws and regulations, the professional accountant shall, subject to paragraph 360.11, discuss the matter with an immediate superior or higher levels of management as deemed appropriate in the circumstances to:
- (a) Confirm the professional accountant's understanding of the facts and circumstances relevant to the matter, and the potential consequences of the matter; and
  - (b) If the matter could have significant consequences for the employing organization or others, understand what actions the immediate superior, management or those charged with governance plan to take to address it, including whether they plan to disclose it to an appropriate authority.
- 360.9 Professional accountants in business can be involved in a variety of roles involving the preparation and reporting of financial information as well as general management activities. Employing organizations rely on their expertise to help ensure that the business activities are undertaken in accordance with relevant laws and regulations. Accordingly, the professional accountant may consider whether management or those charged with governance understand their legal or regulatory responsibilities with respect to the matter and, if not, may recommend that the employing organization obtain legal advice.
- 360.10 If insufficient information is obtained to satisfy the professional accountant that the employing organization is in compliance with laws and regulations, the professional accountant may consider the need to consult with a relevant professional body or obtain legal advice regarding possible actions to take.
- 360.11 In certain circumstances, the professional accountant may deem it more appropriate to communicate the matter in accordance with the protocols established by the employing organization's ethics policy where such protocols allow for anonymity, rather than discussing the matter with an immediate superior or higher levels of management. This may be appropriate when the professional accountant is employed in a relatively junior position and believes that the non-compliance is deliberate and involves different layers of management. This will enable the matter to be rapidly escalated to those best able to address it.

#### Evaluating the Response of Management or Those Charged with Governance

- 360.12 If the matter could have significant consequences for the employing organization or others, the professional accountant shall evaluate whether the professional accountant's immediate superior, management or those charged with governance have taken appropriate remedial action. In so doing, the professional accountant shall consider the nature and gravity of the matter and factors such as whether:
- The matter has been adequately investigated;
  - Action has been taken to remediate the matter;

- Appropriate steps have been taken to reduce the risk of re-occurrence, such as for example, additional controls or training; and
  - The matter has been disclosed to an appropriate authority where appropriate and, if so, whether the disclosure appears adequate.
- 360.13 The degree to which the professional accountant is able to evaluate the response of the professional accountant's immediate superior, management or those charged with governance may vary with the professional accountant's position within the employing organization. Generally, the higher the professional accountant's position within the employing organization, the greater the professional accountant's access to information and higher levels of management.
- 360.14 If, having evaluated the response to a matter that could have significant consequences for the employing organization or others, the professional accountant believes that the response is not appropriate, or the professional accountant suspects that the immediate superior or management is involved in the non-compliance, or the professional accountant is unable to assess whether the response is appropriate, the professional accountant shall:
- (a) Escalate the matter within the employing organization, for example with higher levels of management, internal audit, or those charged with governance;
  - (b) Disclose the matter in accordance with any established mechanism such as an ethics policy; or
  - (c) Consider disclosing the matter to the employing organization's external auditor, if any, to enable the auditor to determine appropriate actions in the context of the external audit.
- 360.15 If the professional accountant is unable to escalate the matter, or if the professional accountant has doubts about the integrity or honesty of management and those charged with governance and there is no established mechanism such as an ethics policy, the professional accountant may consider discussing the matter with a relevant professional body or legal counsel to understand the professional accountant's options and the professional or legal implications of taking any particular course of action.
- 360.16 If, in the professional accountant's opinion, management or those charged with governance have not taken the remedial action the professional accountant considers appropriate in the circumstances, the professional accountant shall consider whether to disclose the matter to an appropriate authority in accordance with paragraphs 360.17-360.22.

#### Disclosure of Non-Compliance with Laws and Regulations to an Appropriate Authority

- 360.17 Where there are legal or regulatory provisions governing the reporting of non-compliance to an appropriate authority, the professional accountant shall comply with such provisions.
- 360.18 A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. Accordingly, where there are no legal or regulatory provisions governing the reporting of non-compliance, the professional accountant shall consider the gravity of the matter and whether nevertheless to disclose the matter to an appropriate authority, provided that such disclosure would not be contrary to law or regulation.
- 360.19 The gravity of the matter depends on the likely consequences to those potentially affected by the matter in both financial and non-financial terms, including the nature and extent of any

damage to the wider public. In considering whether to disclose, the professional accountant may also take into account the following:

- The degree to which the relevant information is known and substantiated.
- Whether there is an appropriate authority to receive the information. An appropriate authority is one that has acknowledged that it can receive such information and cause the matter to be investigated. The appropriate authority to which to disclose the matter will depend upon the nature of the matter, for example, a securities regulator in the case of fraudulent financial reporting or tax authorities in the case of tax evasion.

The existence of protection from civil or criminal liability or retaliation afforded by legislation or regulation, such as under whistle blowing legislation or regulation, may also be a factor to consider.

- 360.20 The professional accountant is encouraged to seek legal advice to understand the legal implications of disclosure to an appropriate authority.
- 360.21 If the professional accountant decides to disclose the non-compliance to an appropriate authority in such a situation, this would not be considered a breach of the duty of confidentiality under this Code. When making such disclosure, the professional accountant shall act in good faith and exercise caution when making statements and assertions.
- 360.22 The professional accountant may also consider resigning from the employing organization. Resignation, however, is not a substitute for complying with this section.

#### *Documentation*

- 360.23 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. 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.
- 360.24 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.

**PROPOSED CHANGES TO OTHER SECTIONS OF THE CODE  
(DECEMBER 2013 – MARK-UP FROM AUGUST 2012 ED)**

**SECTION 100**

**Introduction and Fundamental Principles**

...

*Fundamental Principles*

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

...

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

...

*Ethical Conflict Resolution*

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

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

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

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

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

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

100.23 If a significant conflict cannot be resolved, a professional accountant may consider obtaining professional advice from the relevant professional body or from legal advisors. The professional accountant generally can obtain guidance on ethical issues without breaching the fundamental principle of confidentiality if the matter is discussed with the relevant professional body on an

anonymous basis or with a legal advisor under the protection of legal privilege. ~~Instances in which the professional accountant may consider obtaining legal advice vary.~~

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

## SECTION 140

### Confidentiality

- 140.1 The principle of confidentiality imposes an obligation on all professional accountants to refrain from:
- (a) Disclosing outside the firm, or employing organization ~~or the auditor~~ confidential information acquired as a result of professional and business relationships without proper and specific authority or unless there is a legal or professional right or duty to disclose; and
  - (b) Using confidential information acquired as a result of professional and business relationships to their personal advantage or the advantage of third parties.
- 140.2 A professional accountant shall maintain confidentiality, including in a social environment, being alert to the possibility of inadvertent disclosure, particularly to a close business associate or a close or immediate family member.
- 140.3 A professional accountant shall maintain confidentiality of information disclosed by a prospective client or employer.
- 140.4 A professional accountant shall maintain confidentiality of information within the firm or employing organization.
- 140.5 A professional accountant shall take reasonable steps to ensure that staff under the professional accountant's control and persons from whom advice and assistance is obtained respect the professional accountant's duty of confidentiality.
- 140.6 The need to comply with the principle of confidentiality continues even after the end of relationships between a professional accountant and a client or employer. When a professional accountant changes employment or acquires a new client, the professional accountant is entitled to use prior experience. The professional accountant shall not, however, use or disclose any confidential information either acquired or received as a result of a professional or business relationship.

#### Circumstances Where Confidential Information May be Disclosed

- 140.7 ~~The following~~ As a fundamental principle, confidentiality serves the public interest because it facilitates the free flow of information between a professional accountant and the professional accountant's client or employer. Nevertheless, there are circumstances where the professional accountants ~~are~~ is or may be required to disclose confidential information, ~~or~~ where such disclosure may be appropriate:
- 140.8 A professional accountant may override the duty of confidentiality when:
- (a) Disclosure is required by law or regulation, ~~for example~~;
  - (b) There is a professional duty or right to disclose, when not prohibited by law or regulation; or
  - (c) Disclosure is permitted by law and is authorized by the client or the employer;

140.9 Circumstances where disclosure is required by law or regulation may include, for example:

- ~~(i)~~ Production of documents or other ~~provision of~~ evidence in the course of legal proceedings; ~~or.~~
- ~~(ii)~~ Disclosure to the appropriate public authorities of ~~infringements of the law non-compliance with laws and regulations~~ that comes to light; ~~and.~~

140.10 Circumstances where a professional accountant may have a professional duty or right to disclose include, for example:

- (~~ia~~) To comply with the quality review of a member body or professional body;
- (~~ib~~) To respond to an inquiry or investigation by a member body or regulatory body;
- (~~ic~~) To protect the professional interests of a professional accountant in legal proceedings; ~~or~~
- (~~id~~) To comply with technical ~~and ethics~~ standards,
- (~~v~~) ~~To comply with requirements contained in Sections 225 and 360 in this Code.~~

~~140.8~~ ~~Sections 225 and 360 describe the circumstances where a professional accountant shall or has a right to override the fundamental principle of confidentiality and disclose a~~ such as when disclosing identified or suspected illegal act non-compliance with laws and regulations to an appropriate authority in the circumstances described in Sections 225 and 360.

140.11 ~~In other situations, where the professional accountant has discretion i~~ In deciding whether to disclose confidential information, relevant factors to consider include:

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

## SECTION 150

### Professional Behavior

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

## SECTION 210

### Professional Appointment

#### *Client Acceptance and Continuance*

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

210.~~23~~ A professional accountant in public practice shall evaluate the significance of any threats and apply safeguards when necessary to eliminate them or reduce them to an acceptable level.

Examples of such safeguards include:

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

210.~~34~~ Where it is not possible to reduce the threats to an acceptable level, the professional accountant in public practice shall decline to enter into the client relationship.

210.~~45~~ Potential threats to compliance with the fundamental principles may have been created after acceptance that would have caused the professional accountant to decline the engagement had that information been available earlier. A professional accountant in public practice shall, therefore, periodically review whether to continue with a recurring client engagement. For example, a threat to compliance with the fundamental principles may be created by a client's unethical behavior such as improper earnings management or balance sheet valuations. If a professional accountant in public practice identifies a threat to compliance with the fundamental principles, the accountant shall evaluate the significance of the threats and apply safeguards when necessary to eliminate the threat or reduce it to an acceptable level. Where it is not possible to reduce the threat to an acceptable level, the professional accountant in public practice shall consider terminating the client relationship where termination is not prohibited by law or regulation.

#### *Engagement Acceptance*

210.~~56~~ The fundamental principle of professional competence and due care imposes an obligation on a professional accountant in public practice to provide only those services that the professional accountant in public practice is competent to perform. Before accepting a specific client engagement, a professional accountant in public practice shall determine whether acceptance would create any threats to compliance with the fundamental principles. For example, a self-interest threat to professional competence and due care is created if the engagement team does not possess, or cannot acquire, the competencies necessary to properly carry out the engagement.

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

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

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

#### *Changes in a Professional Appointment*

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

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

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

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

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

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

210.11~~3~~ An existing accountant is bound by confidentiality. Whether that professional accountant is permitted or required to discuss the affairs of a client with a proposed accountant will depend on the nature of the engagement and on:

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

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

210.12~~4~~ A professional accountant in public practice will generally need to obtain the client's permission, preferably in writing, to initiate discussion with an existing accountant. Once that permission is obtained, the existing accountant shall comply with relevant legal and other regulations governing such requests. Where the existing accountant provides information, it shall be provided honestly and unambiguously. If the proposed accountant is unable to communicate with the existing accountant, the proposed accountant shall take reasonable steps to obtain information about any possible threats by other means, such as through inquiries of third parties or background investigations of senior management or those charged with governance of the client.

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

210.14~~2~~ A professional accountant in public practice may be asked to undertake work that is complementary or additional to the work of the existing accountant. Such circumstances may create threats to professional competence and due care resulting from, for example, a lack of or incomplete information. The significance of any threats shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. An example of such a safeguard is notifying the existing accountant of the proposed work, which would give

the existing accountant the opportunity to provide any relevant information needed for the proper conduct of the work.

## SECTION 300

### Introduction

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300.5 A professional accountant in business may hold a senior position within an organization. The more senior the position, the greater will be the ability and opportunity to influence events, practices and attitudes. A professional accountant in business is expected, therefore, to encourage an ethics-based culture in an employing organization that emphasizes the importance that senior management places on ethical behavior. Established 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 procedures help to encourage ethical behavior and increase the likelihood of senior management being alerted to a problem in time to prevent serious damage.

300.6 A professional accountant in business shall not knowingly engage in any business, occupation, or activity that:

- ~~• Would be incompatible with the professional accountant's responsibility to act in the public interest.~~
- A reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances available to the professional accountant at that time, impairs or might impair the professional accountant's integrity, or objectivity, or the good reputation of the profession.

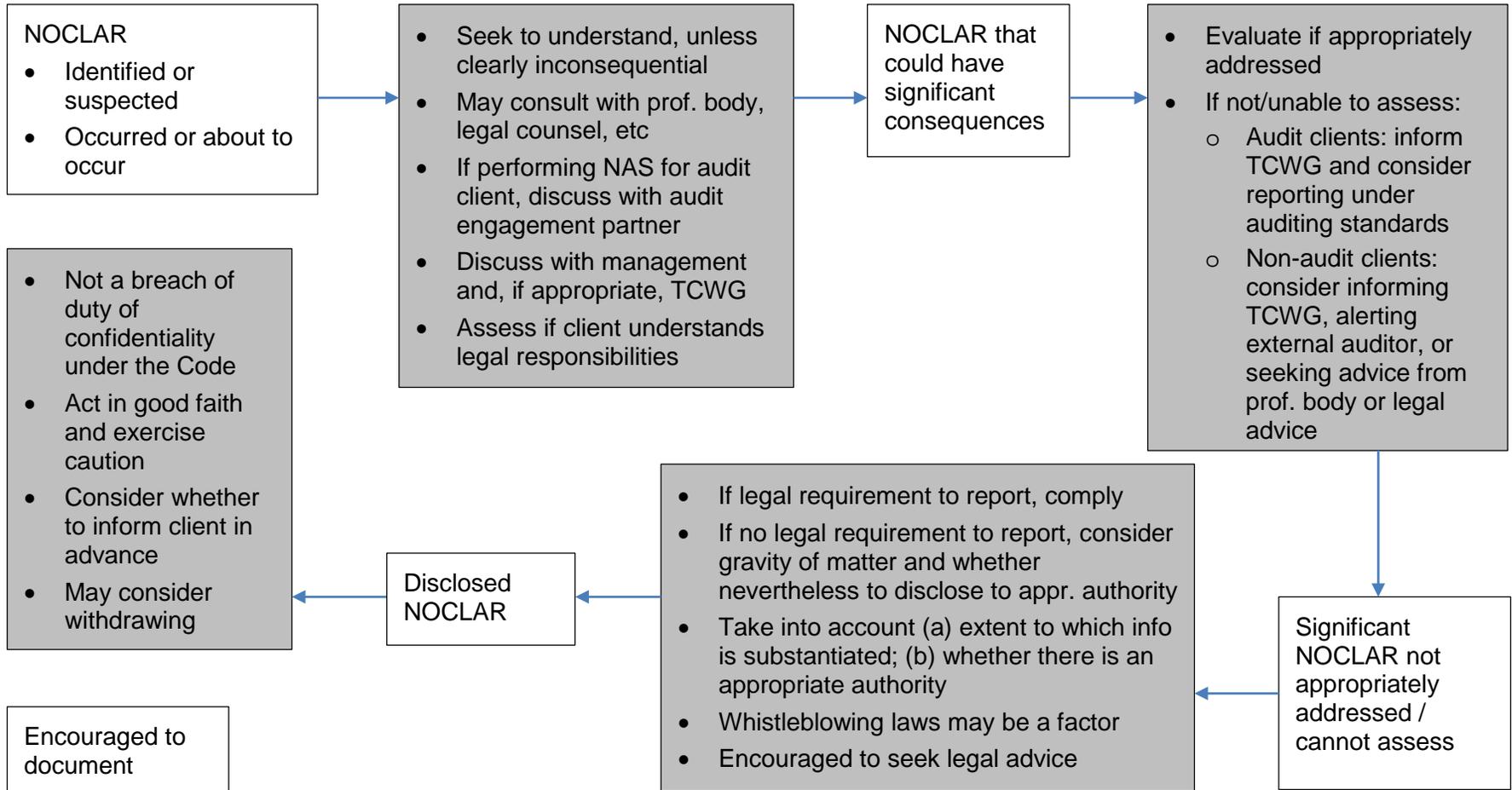
~~Examples include improper earnings management or balance sheet valuations.~~

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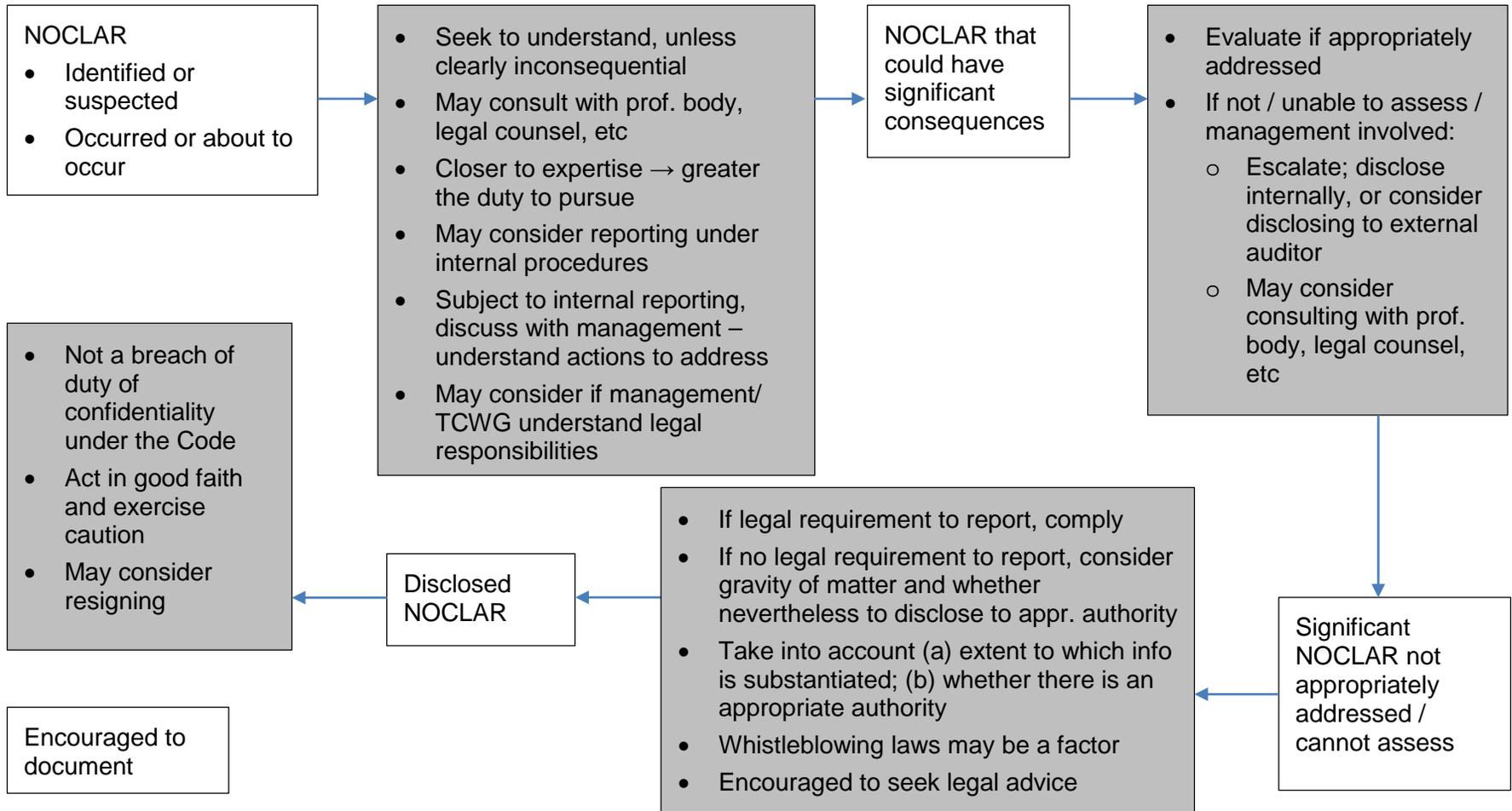
300.15 If a professional accountant in business believes that unethical behavior or actions by others will continue to ~~has occurred~~ within the employing organization, the professional accountant ~~shall discuss the matter with the appropriate level of management. If the response to the matter is not appropriate, the professional accountant shall escalate the matter to higher levels of management to the extent possible. If the response is still not appropriate, the professional accountant shall discuss the matter with those charged with governance, if possible. If, in the professional accountant's judgment, the response to the matter is not appropriate, the professional accountant may consider~~ first reporting such matters in accordance with the employing organization's established ethics policies and whistle-blowing procedures. Where such policies and procedures do not exist, the professional accountant may consider consulting with a relevant professional body ~~on an anonymous basis~~ or obtaining legal advice. In circumstances where all available safeguards have been exhausted and it is not possible to reduce the threat to an acceptable level, a professional accountant ~~and may conclude that it is appropriate to consider~~ resigning from the employing organization.

APPENDIX 3

PROPOSED SECTION 225 – PROFESSIONAL ACCOUNTANTS IN PUBLIC PRACTICE



**PROPOSED SECTION 360 – PROFESSIONAL ACCOUNTANTS IN BUSINESS**





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