

NOCLAR—Proposed Section 260 (Clean)

Responding to Non-Compliance with Laws and Regulations

Introduction

- 260.1 Professional accountants are required to comply with the fundamental principles and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats.
- 260.2 Threats to compliance with the principles of integrity and professional behavior are created when an accountant becomes aware of an act or suspected act of non-compliance with laws and regulations.
- 260.3 Section 260 sets out requirements and application material regarding the approach to be taken by a professional accountant when responding to non-compliance or suspected non-compliance with:
- (a) Laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the employing organization's financial statements; and
 - (b) Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the employing organization's financial statements, but compliance with which might be fundamental to the operating aspects of the employing organization's business, to its ability to continue its business, or to avoid material penalties.

Requirements and Application Material

General

- 260.4 A1 Non-compliance with laws and regulations ("non-compliance") comprises acts of omission or commission, intentional or unintentional, which are contrary to the prevailing laws or regulations committed by the following parties:
- (a) The professional accountant's employing organization;
 - (b) Those charged with governance;
 - (c) Management; or
 - (d) Other individuals working for or under the direction of the employing organization.
- 260.4 A2 Examples of laws and regulations which this section addresses include those that deal with:
- Fraud, corruption and bribery.
 - Money laundering, terrorist financing and proceeds of crime.
 - Securities markets and trading.

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

R260.5 The professional accountant shall apply this section regardless of the nature of the employing organization, including whether or not it is a public interest entity.

260.5 A1 A professional accountant might encounter or be made aware of non-compliance or suspected non-compliance with laws and regulations in the course of carrying out professional activities. This section guides the accountant in assessing the implications of the matter and the possible courses of action when responding to it.

R260.6 In some jurisdictions, there are legal or regulatory provisions governing how professional accountants are required to address non-compliance or suspected non-compliance. These legal or regulatory provisions might differ from or go beyond the provisions in this section. When encountering such non-compliance or suspected non-compliance, the accountant shall obtain an understanding of those legal or regulatory provisions and comply with them, including:

- (a) Any requirement to report the matter to an appropriate authority; and
- (b) Any prohibition on alerting the relevant party prior to making any disclosure

260.6 A1 A prohibition on alerting the client prior to making any disclosure might arise, for example, pursuant to anti-money laundering legislation.

260.7 A1 A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. When responding to non-compliance or suspected non-compliance, the objectives of the professional accountant are:

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

260.7 A2 Non-compliance might result in fines, litigation or other consequences for the employing organization, potentially materially affecting its financial statements. Importantly, such non-compliance might have wider public interest implications in terms of potentially substantial harm to investors, creditors, employees or the general public. For the purposes of this section, an act that causes substantial harm is one that results in serious adverse consequences to any of these parties in financial or non-financial terms.

Examples include the perpetration of a fraud resulting in significant financial losses to investors, and breaches of environmental laws and regulations endangering the health or safety of employees or the public.

260.7 A3 A professional accountant who encounters or is made aware of matters that are clearly inconsequential is not required to comply with this section. Whether a matter is clearly inconsequential is to be judged with respect to its nature and its impact, financial or otherwise, on the employing organization, its stakeholders and the general public.

260.7 A4 This section does not address:

- (a) Personal misconduct unrelated to the business activities of the employing organization; and
- (b) Non-compliance by parties other than those specified in paragraph 260.4 A1.

The professional accountant might nevertheless find the guidance in this section helpful in considering how to respond in these situations.

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

260.8 A1 The employing organization’s management, with the oversight of those charged with governance, is responsible for ensuring that the employing organization’s business activities are conducted in accordance with laws and regulations. Management and those charged with governance are also responsible for identifying and addressing any non-compliance by:

- (a) The employing organization;
- (b) An individual charged with governance of the entity;
- (c) A member of management; or
- (d) Other individuals working for or under the direction of the employing organization.

Responsibilities of Professional Accountants

R260.9 If protocols and procedures exist within the professional accountant’s employing organization to address non-compliance or suspected non-compliance, the accountant shall consider them in determining how to respond to such non-compliance.

260.9 A1 Many employing organizations have established protocols and procedures regarding how to raise non-compliance or suspected non-compliance internally. These protocols and procedures include, for example, an ethics policy or internal whistle-blowing mechanism. Such protocols and procedures might allow matters to be reported anonymously through designated channels.

R260.10 Where a professional accountant becomes aware of a matter to which this section applies, the steps that the accountant takes to comply with this section shall be taken on a timely basis. For the purpose of taking timely steps, the accountant shall have regard to the nature of the matter and the potential harm to the interests of the employing organization, investors, creditors, employees or the general public.

Responsibilities of Senior Professional Accountants in Business

260.11 A1 Senior professional accountants in business (“senior professional accountants”) are directors, officers or senior employees able to exert significant influence over, and make decisions regarding, the acquisition, deployment and control of the employing organization’s human, financial, technological, physical and intangible resources. There is a greater expectation for them to take whatever action is appropriate in the public interest to respond to non-compliance or suspected non-compliance than other accountants within the employing organization. This is because of senior professional accountants’ roles, positions and spheres of influence within the employing organization.

Obtaining an Understanding of the Matter

R260.12 If, in the course of carrying out professional activities, a senior professional accountant becomes aware of information concerning an instance of non-compliance or suspected non-compliance, the accountant shall obtain an understanding of the matter. This understanding shall include:

- (a) The nature of the act and the circumstances in which it has occurred or might occur;
- (b) The application of the relevant laws and regulations to the circumstances; and
- (c) The potential consequences to the employing organization, investors, creditors, employees or the wider public.

260.12 A1 A senior professional accountant is expected to apply knowledge and expertise, and exercise professional judgment. However, the accountant is not expected to have a level of understanding of laws and regulations greater than that which is required for the accountant’s role within the employing organization. Whether an act constitutes non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body.

260.12 A2 Depending on the nature and significance of the matter, the senior professional accountant might cause, or take appropriate steps to cause, the matter to be investigated internally. The accountant might also consult on a confidential basis with others within the employing organization or a professional body, or with legal counsel.

Addressing the Matter

R260.13 If the senior professional accountant identifies or suspects that non-compliance has occurred or might occur, the accountant shall, subject to paragraph R260.9, discuss the matter with the accountant’s immediate superior, if any. If the accountant’s immediate superior appears to be involved in the matter, the accountant shall discuss the matter with the next higher level of authority within the employing organization.

260.13 A1 The purpose of the discussion is to enable a determination to be made as to how to address the matter.

R260.14 The senior professional accountant shall also take appropriate steps to:

- (a) Have the matter communicated to those charged with governance;

- (b) Comply with applicable laws and regulations, including legal or regulatory provisions governing the reporting of non-compliance or suspected non-compliance to an appropriate authority;
- (c) Have the consequences of the non-compliance or suspected non-compliance rectified, remediated or mitigated;
- (d) Reduce the risk of re-occurrence; and
- (e) Seek to deter the commission of the non-compliance if it has not yet occurred.

260.14 A1 The purpose of communicating the matter to those charged with governance is to obtain their concurrence regarding appropriate actions to take to respond to the matter and to enable them to fulfill their responsibilities.

R260.15 In addition to responding to the matter in accordance with the provisions of this section, the senior professional accountant shall determine whether disclosure of the matter to the employing organization's external auditor, if any, is needed.

260.15 A1 Such disclosure would be pursuant to the senior professional accountant's duty or legal obligation to provide all information necessary to enable the auditor to perform the audit.

Determining Whether Further Action Is Needed

R260.16 The senior professional accountant shall assess the appropriateness of the response of the accountant's superiors, if any, and those charged with governance.

260.16 A1 Relevant factors to consider in assessing the appropriateness of the response of the senior professional accountant's superiors, if any, and those charged with governance include whether:

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

R260.17 In light of the response of the senior professional accountant's superiors, if any, and those charged with governance, the accountant shall determine if further action is needed in the public interest.

260.17 A1 The determination of whether further action is needed, and the nature and extent of it, will depend on various factors, including:

- The legal and regulatory framework.
- The urgency of the situation.
- The pervasiveness of the matter throughout the employing organization.
- Whether the senior professional accountant continues to have confidence in the integrity of the accountant's superiors and those charged with governance.

- Whether the non-compliance or suspected non-compliance is likely to recur.
- Whether there is credible evidence of actual or potential substantial harm to the interests of the employing organization, investors, creditors, employees or the general public.

260.17 A2 Examples of circumstances that might cause the senior professional accountant no longer to have confidence in the integrity of the accountant's superiors and those charged with governance include situations where:

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

R260.18 The senior professional accountant shall exercise professional judgment in determining the need for, and nature and extent of, further action. In making this determination, the accountant shall take into account whether a reasonable and informed third party would be likely to conclude that the accountant has acted appropriately in the public interest.

260.18 A1 Further action that the senior professional accountant might take includes:

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

260.18 A2 Resigning from the employing organization is not a substitute for taking other actions that might be needed to achieve the senior professional accountant's objectives under this section. In some jurisdictions, however, there might be limitations as to the further actions available to the accountant. In such circumstances, resignation might be the only available course of action.

260.19 A1 As consideration of the matter might involve complex analysis and judgments, the senior professional accountant might consider:

- Consulting internally.
- Obtaining legal advice to understand the accountant's options and the professional or legal implications of taking any particular course of action.
- Consulting on a confidential basis with a regulator or professional body.

Determining Whether to Disclose the Matter to an Appropriate Authority

260.20 A1 Disclosure of the matter to an appropriate authority would be precluded if doing so would be contrary to law or regulation. Otherwise, the purpose of making disclosure is to enable an appropriate authority to cause the matter to be investigated and action to be taken in the public interest.

260.20 A2 The determination of whether to make such a disclosure depends in particular on the nature and extent of the actual or potential harm that is or might be caused by the matter to investors, creditors, employees or the general public. For example, the senior professional accountant might determine that disclosure of the matter to an appropriate authority is an appropriate course of action if:

- The employing organization is engaged in bribery (for example, of local or foreign government officials for purposes of securing large contracts).
- The employing organization is regulated and the matter is of such significance as to threaten its license to operate.
- The employing organization is listed on a securities exchange and the matter might result in adverse consequences to the fair and orderly market in the employing organization's securities or pose a systemic risk to the financial markets.
- It is likely that the employing organization would sell products that are harmful to public health or safety.
- The employing organization is promoting a scheme to its clients to assist them in evading taxes.

260.20 A3 The determination of whether to make such a disclosure will also depend on external factors such as:

- Whether there is an appropriate authority that is able to receive the information, and cause the matter to be investigated and action to be taken. The appropriate authority will depend upon the nature of the matter. For example, the appropriate authority would be a securities regulator in the case of fraudulent financial reporting or an environmental protection agency in the case of a breach of environmental laws and regulations.
- Whether there exists robust and credible protection from civil, criminal or professional liability or retaliation afforded by legislation or regulation, such as under whistle-blowing legislation or regulation.
- Whether there are actual or potential threats to the physical safety of the senior professional accountant or other individuals.

R260.21 If the senior professional accountant determines that disclosure of the matter to an appropriate authority is an appropriate course of action in the circumstances, this is not a breach of the duty of confidentiality under Subsection 114 of the Code. When making such disclosure, the accountant shall act in good faith and exercise caution when making statements and assertions.

R260.22 In exceptional circumstances, the senior professional accountant might become aware of actual or intended conduct that the accountant has reason to believe would constitute an imminent breach of a law or regulation that would cause substantial harm to investors, creditors, employees or the general public. In these circumstances, the accountant shall exercise professional judgment and may immediately disclose the matter to an appropriate authority in order to prevent or mitigate the consequences of such imminent

breach. Such disclosure is not a breach of the duty of confidentiality under Subsection 114 of the Code.

260.22 A1 Prior to deciding whether to disclose the matter to an appropriate authority immediately, the professional accountant might consider whether it would be appropriate to discuss the matter with management or those charged with governance of the employing organization.

Documentation

260.23 A1 In relation to an identified or suspected act of non-compliance that falls within the scope of this section, the senior professional accountant is encouraged to have the following matters documented:

- The matter.
- The results of discussions with the accountant's superiors, if any, and those charged with governance and other parties.
- How the accountant's superiors, if any, and those charged with governance have responded to the matter.
- The courses of action the accountant considered, the judgments made and the decisions that were taken.
- How the accountant is satisfied that the accountant has fulfilled the responsibility set out in paragraph R260.17.

Responsibilities of Professional Accountants Other than Senior Professional Accountants in Business

R260.24 If, in the course of carrying out professional activities, a professional accountant becomes aware of information concerning an instance of non-compliance or suspected non-compliance, the accountant shall seek to obtain an understanding of the matter. This understanding shall include the nature of the act and the circumstances in which it has occurred or might occur.

260.24 A1 The professional accountant is expected to apply knowledge and expertise, and exercise professional judgment. However, the accountant is not expected to have a level of understanding of laws and regulations greater than that which is required for the accountant's role within the employing organization. Whether an act constitutes non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body.

260.24 A2 Depending on the nature and significance of the matter, the professional accountant might consult on a confidential basis with others within the employing organization or a professional body, or with legal counsel.

R260.25 If the professional accountant identifies or suspects that non-compliance has occurred or might occur, the accountant shall, subject to paragraph R260.9, inform an immediate superior to enable the superior to take appropriate action. If the accountant's immediate

superior appears to be involved in the matter, the accountant shall inform the next higher level of authority within the employing organization.

R260.26

In exceptional circumstances, the professional accountant may determine that disclosure of the matter to an appropriate authority is an appropriate course of action. If the accountant does so pursuant to paragraphs 260.20 A2 and A3, this is not a breach of the duty of confidentiality under Subsection 114 of the Code. When making such disclosure, the accountant shall act in good faith and exercise caution when making statements and assertions.

Documentation

260.27 A1

In relation to an identified or suspected act of non-compliance that falls within the scope of this section, the professional accountant is encouraged to have the following matters documented:

- The matter.
- The results of discussions with the accountant's superior, management and, where applicable, those charged with governance and other parties.
- How the accountant's superior has responded to the matter.
- The courses of action the accountant considered, the judgments made and the decisions that were taken.