

## Exposure Draft: *Responding to Non-Compliance with Laws and Regulations*

This summary provides an overview of the IESBA's [Exposure Draft, Responding to Non-Compliance with Laws and Regulations](#).

**What is the objective of this project?**

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

**What is the debate about?**

It is about what is reasonable to ask of PAs within their role in the public interest when they come across actual or suspected NOCLAR when providing a professional service to their clients or carrying out their responsibilities for their employer.

**When is the closing date for comments?**

The Exposure Draft is open for public comment through September 4, 2015.

**How can comments be submitted?**

Respondents are asked to submit their comments electronically through the IESBA website, using the "[Submit a Comment](#)" link. Please submit comments in both a PDF and Word file. All comments will be considered a matter of public record and will ultimately be posted on the website.

## Responding to the Exposure Draft

All stakeholders—in particular, regulators and audit oversight bodies, preparers, audit committees, investors, accounting firms, and others who have a role or interest in addressing NOCLAR issues—are encouraged to respond.

### Who should respond?

The IESBA encourages responses to the Exposure Draft from a broad range of stakeholders, including:

- Preparers, who represent a first line of defense against NOCLAR;
- Those charged with governance (TCWG), who have an important role to play in overseeing entities' business conduct in full compliance with all applicable laws and regulations;
- Investors, who will be concerned with any significant breach of laws and regulations by entities in which they have invested, and the related consequences;
- Regulators, who have an interest in being alerted to identified or suspected NOCLAR in order to ensure that the matter is appropriately addressed in the public interest;
- Accountancy firms, including global networks, that have a role to play in responding to identified or suspected NOCLAR; and
- Professional accountancy organizations that can reflect on the profession's role in responding to identified or suspected NOCLAR.

### What are the key matters on which the IESBA is seeking stakeholder feedback?

The IESBA is seeking comments on the following key matters:

- Where there is a legal or regulatory requirement to report identified or suspected NOCLAR to an appropriate authority, do you believe the guidance in the proposals would support the implementation and application of the requirement?
- Where there is no such legal or regulatory reporting requirement, do you believe the proposals would be helpful in guiding PAs in fulfilling their responsibility to act in the public interest in the circumstances?
- What are your views on the practical aspects of the proposals, particularly their impact on the relationships between auditors and audited entities, other PAs in public practice and their clients, and PAIBs and their employers?
- Do you support the proposed framework, including the objectives for all categories of PAs?

## Key Elements of the Proposed Framework

The IESBA believes that the proposed framework is in the public interest. The development of the framework was informed by stakeholder responses to the first Exposure Draft issued in August 2012 and other extensive consultation with stakeholders, including three global roundtables in Hong Kong, Brussels, and Washington, DC in 2014, and discussions with the IESBA Consultative Advisory Group.

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

### What is NOCLAR under the proposed framework?

Any act of omission or commission, intentional or unintentional, committed by a client or employer, or by TCWG, management or employees of a client or employer which is contrary to the prevailing laws or regulations.

### What are the objectives of PAs under the proposed Framework?

- To comply with the fundamental principles of integrity and professional behavior
- By alerting management/TCWG, to seek to:
  - Enable them to rectify, remediate or mitigate the consequences of the identified or suspected NOCLAR; or
  - Deter the commission of NOCLAR
- To take such further action as may be needed in the public interest

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

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

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

### What is not in the scope?

- Matters that are clearly inconsequential
- Personal misconduct unrelated to the business activities of the client or employer
- NOCLAR acts committed by persons other than the client or employer, or TCWG, management or employees of the client or employer

## What Is Required of Auditors under the Proposed Framework?

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

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

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

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

- To clarify their understanding of the matter and to enable management/TCWG to investigate it
- To substantiate or dispel their concerns
- To prompt management/TCWG to:
  - Rectify, remediate or mitigate consequences for stakeholders
  - Deter the act of NOCLAR where it has not yet occurred
  - Disclose the matter to an appropriate authority if required by law or regulation or if necessary in the public interest

### **Fulfill professional responsibilities**

- Understand and comply with applicable laws and regulations
- Comply with professional standards

### **Determine if further action is needed to achieve the objectives**

- The nature and extent of further action needed will depend on various factors, e.g.:
  - The appropriateness and timeliness of the response of management/TCWG
  - Credible evidence of actual or potential substantial harm to the entity or stakeholders
- Courses of further action may include:
  - Disclosing the matter to an appropriate authority
  - Withdrawing from the engagement and client relationship
- This determination is to be made objectively from the perspective of a reasonable and informed third party, taking into account the specific facts and circumstances at the time.

**Document, among other matters, how they are satisfied that the objectives have been met**

## What Is Required of Senior PAIBs under the Proposed Framework?

The proposed framework describes a *senior PAIB* as a director, officer, or senior employee able to exert significant influence over, and make decisions regarding, acquisition, deployment, and control of human, financial, technological, physical, and intangible resources.

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

### Overarching expectations

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

### Fulfill professional responsibilities

- Raise the identified or suspected NOCLAR with a superior/TCWG
- Understand and comply with applicable laws and regulations
- Rectify/remediate/mitigate consequences of the act of NOCLAR
- Seek to deter the act of NOCLAR if it has not yet occurred
- Alert external auditor, if there is one

### Determine if further action is needed to achieve the objectives

- The nature and extent of further action needed will depend on various factors, e.g.:
  - The appropriateness and timeliness of the response of superior/TCWG
  - Credible evidence of actual or potential substantial harm to the employer or stakeholders
- Courses of further action may include:
  - Informing the parent entity in the case of a member of a group
  - Disclosing the matter to an appropriate authority
  - Resigning from the employment relationship
- This determination is to be made objectively from the perspective of a reasonable and informed third party, taking into account the specific facts and circumstances at the time

### Documentation is encouraged

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

The basic ethical principles are the same for all PAs, i.e., they should respond to the issue and not turn a blind eye. However, the implementation of those principles will differ depending on their roles, levels of seniority and spheres of influence.

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

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

### ***Stand back***

- Consider whether further action is needed to achieve the objectives, e.g.:
  - Disclosing the matter to the external auditor, if there is one
  - Disclosing the matter to an appropriate authority
- This will depend on various factors.

### ***Association***

- To comply with the fundamental principles, consider whether to remain associated with the client.

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

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

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

## What Are the Strengths of the Proposed Framework?

The Code operates as part of a wider framework, which needs to include strong corporate governance systems and robust, trusted, and effective legal and regulatory regimes.

The IESBA believes that all the elements of the wider framework are important in ensuring that the issue of NOCLAR is addressed holistically.

### A holistic and balanced model

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

### A proportionate approach

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

### A renewed emphasis on the tone at the top

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

### Expanded auditors' "toolkit"

- It provides a pathway to disclosure of serious identified or suspected NOCLAR to an appropriate authority in the appropriate circumstances, without the duty of confidentiality under the Code standing in the way.
- It requires communication between proposed and existing auditors regarding reasons for the change in appointment.

### Stimulating increased reporting under law or regulation

- By requiring PAs to *understand* the laws and regulations applicable to them when they face identified or suspected NOCLAR, it will enhance compliance by PAs with existing legal or regulatory reporting requirements.
- It will support and complement the legal and regulatory framework by providing the necessary guidance in jurisdictions where there is little or no guidance as to how to implement a legal or regulatory reporting requirement.