
EXPOSURE DRAFT

AICPA PROFESSIONAL ETHICS DIVISION

PROPOSED INTERPRETATIONS

**RESPONDING TO NON-COMPLIANCE WITH
LAWS AND REGULATIONS**

March 10, 2017

Comment deadline is May 12, 2017

Prepared by the AICPA Professional Ethics Executive Committee for comments from persons interested in independence, behavioral, and technical standards matters.

Comments should be addressed to Lisa A. Snyder, Senior Director of the Professional Ethics Division, at lisa.snyder@aicpa-cima.com

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March 10, 2017

This exposure draft contains important proposals for review and comment by the AICPA's membership and other interested parties regarding pronouncements for possible adoption by the Professional Ethics Executive Committee (PEEC). The text and an explanation of the proposed pronouncements are included in this exposure draft.

After the exposure period is concluded and PEEC has evaluated the comments, PEEC may decide to publish the proposed interpretations. Once published, the interpretations will become effective on the last day of the month in which they are published in the Journal of Accountancy, unless otherwise stated in the interpretations.

Your comments are an important part of this process; please take this opportunity to comment. Responses must be received at the AICPA by May 12, 2017. All written replies to this exposure draft will become part of the public record of the AICPA and will be available at <http://aicpa.org/InterestAreas/ProfessionalEthics/Community/ExposureDrafts/Pages/ExposureDrafts.aspx>. Comments received will be considered by PEEC at its July 26--27, 2017 meeting.

Please email comments to Lisa A. Snyder, Director of the Professional Ethics Division at Lisa.Snyder@aicpa-cima.com

Sincerely,

Samuel L. Burke, *Chair*
AICPA Professional Ethics Executive Committee

Lisa A. Snyder, *Senior Director*
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Explanation For the New Interpretations “Responding to Non-Compliance With Laws and Regulations”

PEEC is exposing for comment two new interpretations, each entitled “Responding to Non-Compliance with Laws and Regulations” (ET sec. 1.170.010 and 2.170.010) under the “Integrity and Objectivity Rule” (ET sec. 1.100.001 and 2.100.001), applicable to members in public practice and in business, respectively.

Purpose

In developing the proposed interpretations, PEEC considered the International Ethics Standards Board for Accountants’ (IESBA) new ethics standards, sections 225 and 360, each entitled, Responding to Non-Compliance with Laws and Regulations.¹ PEEC believes that though many of the proposed requirements are consistent with that of the IESBA Code of Ethics for Professional Accountants (IESBA code), certain differences are necessary to enhance the clarity of the proposed interpretations and make them relevant to AICPA members in the United States. Most notably, as discussed further in a subsequent section, certain provisions were not included in the AICPA proposals as they would be incompatible with most state laws and regulations on client and employer confidentiality.

The AICPA Code of Professional Conduct does not currently address guidance for members when they may encounter non-compliance with laws or regulations (NOCLAR) or suspected NOCLAR. PEEC believes the public interest is served with the inclusion of the robust guidance in the proposed interpretations which sets forth a member’s responsibilities when encountering a NOCLAR at a client or within the employing organization. For purposes of this document, the term “NOCLAR” covers both actual NOCLARs and suspected NOCLARs.

The objective of members when encountering a NOCLAR is to enable a client’s or employing organization’s management and those charged with governance to rectify the NOCLAR, mitigate the effects of the NOCLAR or deter the commission of the NOCLAR by alerting the appropriate parties.

Scope

The interpretations state that a NOCLAR comprises acts of omission or commission, intentional or unintentional, committed by a client or an employer, or by those charged with governance, by management or by other individuals working for or under the direction of a client or employer which are contrary to the prevailing laws or regulations. The laws recognized by the interpretations include those generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements. Other laws recognized by the interpretations are those that do not have a direct effect on the material amounts and disclosures in the financial statements, but compliance that may be fundamental to the operating aspects of the business of the client or employing organization, to its ability to continue business or to avoid material penalties. The interpretations do not address personal misconduct unrelated to the business activities of the employing organization.

Though the proposed interpretations require a member to obtain an understanding of the matter when a NOCLAR is discovered, the member is only expected to have a level of knowledge and

¹ Approved in April 2016 for inclusion in the IESBA’s Code of Ethics for Professional Accountants.

understanding of laws and regulations necessary for the *professional service* for which the member was engaged or employed to perform. In addition, for members performing audit services for a client, the proposals are not intended to modify or interpret AU-C section 250, Consideration of Laws and Regulations in an Audit of Financial Statements. The proposed guidance, however, does impose requirements on auditors that go beyond the audit standards for purposes of fulfilling their ethical obligations under the AICPA code.

Confidentiality

A member in public practice or business must remain mindful of the member's obligations under the "Confidential Client Information Rule" (ET sec. 1.700.001) and the "Confidential Information Obtained from Employment or Volunteer Activities" interpretation (ET sec. 2.400.070), respectively, when addressing a NOCLAR and ensure not to disclose the NOCLAR to a third party without the client's consent unless required by law or regulation. Most state boards of accountancy have laws or regulations that would prohibit the disclosure of confidential client or employer information without the client or employer's consent unless required by law or regulation to make such disclosure. Accordingly, the proposed Interpretations do not include the provisions of the IESBA standards relevant to disclosure by the member to an appropriate authority or external auditor (except for a senior professional accountant when dealing with the employing organization's auditor). The IESBA recognizes that some jurisdictions would not permit a professional accountant to disclose confidential client or employer information and thus, the IESBA standards specifically state, "Disclosure of the matter to an appropriate authority would be precluded if doing so would be contrary to law or regulation."

The IESBA standard has a provision that would require a professional accountant in public practice who has withdrawn from a professional relationship, upon request from the successor accountant, to disclose a NOCLAR to the successor accountant. Due to state laws and regulations on confidentiality noted previously, the AICPA proposed interpretation does not contain a similar provision regarding disclosure to a successor accountant. The member would need to obtain the client's permission to discuss the matter with the successor. If the client refuses to permit the member to discuss all matters with the successor, the successor should be mindful of a potential issue. The AICPA code addresses this situation in the "Disclosing Information from Previous Engagements" interpretation (ET sec. 1.700.020)."

Responsibilities of Members in Public Practice

The proposed NOCLAR requirements for members in public practice are generally the same for members who provide attest services and those who provide nonattest services to clients. The IESBA standard, however, distinguishes between auditors and non-auditors with more stringent requirements applicable to auditors. In drafting the proposed interpretation, PEEC believed it was unnecessary to bifurcate the guidance since it did not incorporate the IESBA provisions relevant to disclosure to an appropriate authority and the other provisions were deemed appropriate for auditors and non-auditors alike.

When a member in public practice discovers a NOCLAR, the member is required to obtain an understanding of the matter, including the nature of the act and the circumstances in which it has occurred or may occur. After obtaining an understanding, the member is then required to discuss the matter with the appropriate level of management and, if the member has access to them and it is appropriate, those charged with governance. The proposals therefore recognize that depending on the nature of the engagement, a member might not have access to senior management or those charged with governance. Such discussions alert the appropriate parties

within the client entity so that they are able to address the NOCLAR. The member should advise the client to take appropriate actions to rectify or remediate the NOCLAR, and where appropriate, disclose the matter to an authority where required by law or regulation, for example, if the client is under the jurisdiction of the SEC and the NOCLAR is required to be reported under the SEC's rules.

Group Attest Engagements

When performing professional services for a component of a group during a group attest engagement, the member is required to respond to a NOCLAR in accordance with the interpretation by communicating it to the group engagement partner unless prohibited by law or regulation. This is to enable the group engagement partner to be informed of the matter to determine how the NOCLAR should be addressed. When the group engagement partner becomes aware of a NOCLAR, that member should consider whether the NOCLAR may be relevant to one or more components of the group engagement. The IESBA NOCLAR standard only requires communications for group audit engagements. The PEEC, however, believes it is in the public interest to have the requirements relevant to group audit engagements apply to all *attest engagements*.

Determining Whether Withdrawal Is Necessary

If a member follows the guidance and determines that the response of management is not appropriate, the member is required to consider withdrawing from the engagement, unless prohibited by law or regulation. When making such determination, the member is required to exercise professional judgment and take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances available to the member at the time, would be likely to conclude that the member has acted appropriately and in the public interest. In addition, the proposed guidance lists various factors for the member to consider in making the determination of whether withdrawal might be necessary.

Communication to Client's Auditor

If a member is performing a service for a financial statement audit or review client of the firm, or a component of a financial statement audit or review client of the firm, the member is required to communicate the NOCLAR within the firm in accordance with the firm's policies and procedures. If such policies and procedures do not exist, then the member should communicate directly with the audit or review engagement partner. This would enable the audit or review engagement partner to determine how the NOCLAR should be addressed in accordance with the requirements of the proposed interpretation. If the NOCLAR occurs while a member is performing an audit or review of a client of a network firm, the member is required to consider whether the NOCLAR should be communicated to the network firm.

As noted in the previous section "Confidentiality", If a member is performing a service for a client that is not a financial statement audit or review client of the firm, the member would be prohibited from communicating the NOCLAR to the external auditor.

Documentation

Members in public practice are required to document certain aspects of the NOCLAR. PEEC is more restrictive than IESBA with regards to the documentation requirement for non-auditors. Under the IESBA standard, non-auditors are encouraged to document rather than required to

document. PEEC, however, believes due to the significance of a NOCLAR, documentation should be required in order to retain a record of the professional judgments made and actions taken by the member and to help demonstrate compliance with the requirements of the interpretation.

Responsibilities of Senior Professional Accountants in Business

When responding to a NOCLAR, members in business are required to consider protocols and procedures that may exist within the members' employing organizations. Because of the role and sphere of influence of senior professional accountants in business, there is a greater expectation for them to take whatever action is appropriate in the public interest to respond to a NOCLAR. For purposes of the interpretation, senior professional accountants in business are directors, officers or senior employees able to exert significant influence over, and make decisions regarding, the acquisition, deployment and control of the employing organization's human, financial, technological, physical and intangible resources.

If a member who is a senior professional accountant in business discovers a NOCLAR, the member should obtain an understanding of the matter. The member should discuss the matter with the member's immediate superior to determine how the NOCLAR should be addressed. If the immediate superior is suspected of involvement, the member is required to discuss the matter with the next higher level of authority.

The interpretation requires certain steps be taken by a member who is a senior professional accountant, including having the matter communicated to those charged with governance to obtain concurrence regarding the appropriate actions to take to enable them to fulfill their responsibilities.

In responding to a NOCLAR, the member who is a senior professional accountant is required to determine whether disclosing the matter to the employing organization's external auditor is necessary, pursuant to the member's duty or legal obligation to provide all information necessary to enable the auditor to perform the audit.

Determining Whether Further Action Is Necessary

If a member who is a senior professional accountant in business follows the guidance and determines that the response of management is not appropriate, the member is required to consider whether further action is necessary. The interpretation states that such further action could include informing management of the parent entity of the matter if the employing organization is a member of a group or, in extreme circumstances, resigning from the organization. When making such determination, the member is required to exercise professional judgment and take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances available to the member at the time, would be likely to conclude that the member has acted appropriately and in the public interest. In addition, the proposed guidance lists various factors for the member to consider in making the determination of whether further action might be necessary.

Responsibilities of Other Professional Accountants in Business

A member who is a professional accountant in business (that is, not a senior professional accountant) is required to obtain an understanding of a discovered NOCLAR. The member should discuss the matter with that member's immediate superior to enable the supervisor to take

appropriate action. If the immediate superior is suspected of involvement, the member is required to discuss the matter with the next higher level of authority.

The interpretation requires that the member determine whether disclosure of the matter to the employing organization's external auditor, if any, is necessary pursuant to the member's duty or legal obligation to provide all information necessary to enable the auditor to perform the audit.

Documentation

Both senior professional accountants in business and other professional accountants in business who are members are encouraged to document certain aspects of the NOCLAR. PEEC believes that encouraging documentation is appropriate as the AICPA code currently has no documentation requirements for members in business. This is consistent with the documentation guidance under the IESBA standard.

Effective Date

PEEC believes that a delayed effective date for transition purposes is necessary. Accordingly, PEEC proposes that the final interpretations be effective one year from the last day of the month in which they are published in the Journal of Accountancy.

Questions

1. Should members in public practice who provide only nonattest services to a client be required to document certain aspects of the NOCLAR? Or, rather, should they be encouraged to document certain aspects of the NOCLAR?
2. Is a one year transition period for the effective date appropriate? If not, what is an appropriate time period and why?

Text of Proposed New Interpretation “Responding to Non-Compliance With Laws and Regulations”

(Applicable to Members in Public Practice)

[Terms in italic only are defined terms]

1.170 Responding to Non-Compliance With Laws and Regulations

1.170.010 Responding to Non-Compliance With Laws and Regulations

Introduction

- .01 When a *member* encounters or is made aware of non-compliance or suspected non-compliance with laws and regulations in the course of providing a *professional service* to a *client*, *threats* to compliance with the “*Integrity and Objectivity Rule*” [1.100.001] may exist. The purpose of this interpretation is to set out the *member’s* responsibilities when encountering such non-compliance or suspected non-compliance, and guide the *member* in assessing the implications of the matter and the possible courses of action when responding to it.
- .02 Non-compliance with laws and regulations (non-compliance) comprises acts of omission or commission, intentional or unintentional, that are contrary to the prevailing laws or regulations and are committed by a *client* or by *those charged with governance*, by management, or by other individuals working for or under the direction of a *client*.
- .03 When responding to non-compliance or suspected non-compliance in the course of providing a *professional service* to a *client*, the *member* should consider the *member’s* obligations under the “*Confidential Client Information Rule*” [1.700.001]. For example, a *member* should not disclose the non-compliance or suspected non-compliance to a third party without the *client’s* consent unless expressly permitted under the “*Confidential Client Information Rule*,” such as when reporting the non-compliance or suspected non-compliance to a regulatory authority in order to comply with applicable laws and regulations, as discussed in paragraph.04.
- .04 Some regulators, such as the SEC or state boards of accountancy, may have regulatory provisions governing how a *member* should address non-compliance or suspected non-compliance which may differ from or go beyond this interpretation. In some circumstances, state and federal civil and criminal laws may also impose additional requirements. When encountering non-compliance or suspected non-compliance, a *member* has a responsibility to obtain an understanding of those legal or regulatory provisions and comply with them, including any requirement to report the matter to an appropriate authority, and any prohibition on alerting the *client* prior to making any disclosure.
- .05 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 a *member* are as follows:

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- a. To comply with the [“Integrity and Objectivity Rule”](#) [1.100.001]
- b. To alert management or, when appropriate, [those charged with governance](#) of the [client](#), to enable them to
 - i. 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
- c. To determine whether withdrawal from the engagement and the professional relationship is necessary, when permitted by law and regulation

Scope

.06 This interpretation sets out the approach to be taken by a [member](#) who encounters or is made aware of non-compliance or suspected non-compliance with the following:

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

.07 Examples of laws and regulations which this interpretation addresses include those that deal with these issues:

- a. Fraud, corruption, and bribery
- b. Money laundering
- c. Securities markets and trading
- d. Banking and other financial products and services
- e. Data protection
- f. Tax and pension liabilities and payments
- g. Environmental protection

h. Public health and safety

- .08 Non-compliance may result in fines, litigation, or other consequences for the *client* that may have a material effect on its *financial statements*. Importantly, such non-compliance may have wider public interest implications in terms of potentially substantial harm to investors, creditors, employees, or the general public. For the purposes of this interpretation, 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.
- .09 A *member* who encounters or is made aware of matters that are clearly inconsequential in their nature and their impact, financial or otherwise, on the *client*, its stakeholders and the general public, is not required to comply with this interpretation with respect to such matters.
- .10 This interpretation does not address the following:
- a. Personal misconduct unrelated to the business activities of the *client*.
 - b. Non-compliance other than by the *client* or *those charged with governance*, management, or other individuals working for or under the direction of the *client*. This includes, for example, circumstances in which a *member* has been engaged by a *client* to perform a due diligence assignment on a third party entity and the identified or suspected non-compliance has been committed by that third party.

A *member* may nevertheless find the guidance in this interpretation helpful in considering how to respond in these situations.

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

- .11 The *client's* management is responsible, with the oversight of *those charged with governance*, to ensure that the *client's* business activities are conducted in accordance with laws and regulations. It is also the responsibility of management and *those charged with governance* to identify and address any non-compliance by the *client*, by an individual charged with governance of the entity, by a *member* of management, or by other individuals working for or under the direction of the *client*

Responsibilities of Members in Public Practice

- .12 When a *member* becomes aware of a matter to which this interpretation applies, the *member* should take timely steps to comply with this interpretation, taking into account the *member's* understanding of the nature of the matter and the potential harm to the interests of the entity, investors, creditors, employees or the general public.

Obtaining an Understanding of the Matter

- .13 If a member engaged to perform professional services becomes aware of information concerning an instance of non-compliance or suspected non-compliance, whether in the course of performing the engagement or through information provided by other parties, the *member* should obtain an understanding of the matter, including the nature of the act and the circumstances in which it has occurred or may occur.
- .14 A member is expected to apply knowledge, professional judgment, and expertise, but is not expected to have a level of knowledge of laws and regulations greater than that required to undertake the engagement. Whether an act constitutes non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body. Depending on the nature and significance of the matter, the *member* may consult on a confidential basis with others within the firm, a network firm or a professional body, or with legal counsel.
- .15 If the member identifies or suspects that non-compliance has occurred or may occur, the *member* should discuss the matter with the appropriate level of management and, if the *member* has access to them and when appropriate, those charged with governance.
- .16 Such discussion serves to clarify the member's understanding of the facts and circumstances relevant to the matter and its potential consequences. The discussion also may prompt management or those charged with governance to investigate the matter.
- .17 The appropriate level of management with whom to discuss the matter is a question of professional judgment. Relevant factors to consider include these:
- a. The nature and circumstances of the matter
 - b. The individuals actually or potentially involved
 - c. The likelihood of collusion
 - d. The potential consequences of the matter
 - e. Whether that level of management is able to investigate the matter and take appropriate action
- .18 The appropriate level of management is generally at least one level above the person or persons involved or potentially involved in the matter. If a member believes that management is involved in the non-compliance or suspected non-compliance, the *member* should discuss the matter with those charged with governance. The *member* may also consider discussing the matter with internal auditors, when applicable. In the context of a group attest engagement, the appropriate level may be management at an entity that controls the client.

Addressing the Matter

.19 In discussing the non-compliance or suspected non-compliance with management and, when appropriate, those charged with governance, the member should advise them to take the following appropriate and timely actions, if they have not already done so:

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

.20 The member should consider whether the client's management and those charged with governance understand their legal or regulatory responsibilities with respect to the non-compliance or suspected non-compliance. If not, the member may suggest appropriate sources of information or recommend that they obtain legal advice.

.21 The member should comply with the following:

- a. Applicable laws and regulations, including legal or regulatory provisions governing the reporting of non-compliance or suspected non-compliance to an appropriate authority. In this regard, some laws and regulations may stipulate a period within which reports are to be made.
- b. Applicable requirements under auditing or other professional standards, including those relating to
 - i. identifying and responding to non-compliance, including fraud.
 - ii. communicating with those charged with governance.
 - iii. considering the implications of the non-compliance or suspected non-compliance for the auditor's report.

Communication With Respect to Group Attest Engagements

.22 A member may do the following:

- a. For purposes of a group attest engagement, be requested by the group engagement team to perform work on financial or other information related to a component of the group
- b. Be engaged to perform an attest engagement of a component for purposes other than the group attest engagement, for example, a statutory audit

If the *member* becomes aware of non-compliance or suspected non-compliance in relation to the component in either situation, the *member* should, in addition to responding to the matter in accordance with the provisions of this interpretation, communicate it to the group engagement *partner* unless prohibited from doing so by law or regulation. This is to enable the group engagement *partner* to be informed about the matter and to determine, in the context of the group *attest engagement*, whether it should be addressed in accordance with the provisions in this interpretation and, if so, how.

.23 If the group engagement *partner* becomes aware of non-compliance or suspected non-compliance in the course of a group *attest engagement*, including as a result of being informed of such a matter in accordance with paragraph .22, the group engagement *partner* should, in addition to responding to the matter in the context of the group *attest engagement* in accordance with the provisions of this interpretation, consider whether the matter may be relevant to one or more components:

- a. Whose financial or other information is subject to procedures performed for purposes of the group *attest engagement*
- b. Whose financial or other information is subject to procedures performed for purposes other than the group *attest engagement*, for example, a statutory audit

In these circumstances, the group engagement *partner* should take steps to have the non-compliance or suspected non-compliance communicated to those performing work at components where the matter may be relevant, unless prohibited from doing so by law or regulation. If necessary in relation to paragraph 23b, appropriate inquiries should be made (either of management or from publicly available information) as to whether the relevant component is subject to attest procedures and, if so, to ascertain, to the extent practicable, the identity of the accountant. The communication is to enable those responsible for work at such components to be informed about the matter and to determine whether and, if so, how it should be addressed in accordance with the provisions in this interpretation.

Determining Whether Withdrawal From the Engagement Is Necessary

.24 The *member* should assess the appropriateness of the response of management and, if applicable, *those charged with governance*.

.25 Relevant factors to consider in assessing the appropriateness of the response of management and, where applicable, *those charged with governance* include whether

- a. the response is timely.
- b. the non-compliance or suspected non-compliance has been adequately investigated.
- c. action has been, or is being, taken to rectify, remediate, or mitigate the consequences of any non-compliance.

- d. action has been or is being taken to deter the commission of any non-compliance if it has not yet occurred.
- e. appropriate steps have been, or are being, taken to reduce the risk of recurrence, for example, additional controls or training.
- f. the non-compliance or suspected non-compliance has been disclosed to an appropriate authority where appropriate and, if so, whether the disclosure appears adequate.

.26 In light of the response of management and, if applicable, those charged with governance, the member should determine whether withdrawing from the engagement and the professional relationship is necessary, where permitted by law and regulation.

.27 The determination of whether withdrawing from the engagement and the professional relationship is necessary, will depend on various factors, including these:

- a. The legal and regulatory framework
- b. The urgency of the matter
- c. The pervasiveness of the matter throughout the client
- d. Whether the member continues to have confidence in the integrity of management and, if applicable, those charged with governance
- e. Whether the non-compliance or suspected non-compliance is likely to recur
- f. Whether there is credible evidence of actual or potential substantial harm to the interests of the entity, investors, creditors, employees, or the general public

.28 Examples of circumstances that may cause a member no longer to have confidence in the integrity of management and, where applicable, those charged with governance include situations such as the following:

- a. The member suspects or has evidence of management's involvement or intended involvement in any non-compliance.
- b. The member is aware that management has knowledge of such non-compliance and, contrary to legal or regulatory requirements, has not reported, or authorized the reporting of, the matter to an appropriate authority within a reasonable period.

.29 In determining the need to withdraw from the engagement and the professional relationship, a member should exercise professional judgment and take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances available to the

member at the time, would be likely to conclude that the *member* has acted appropriately and in the public interest.

- .30 As consideration of the matter may involve complex analysis and judgments, a [member](#) may consider consulting internally, obtaining legal advice to understand the *member's* options and the professional or legal implications of taking any particular course of action, or consulting on a confidential basis with a regulator or professional body.

Communicating the Matter to the Client's Auditor

- .31 If the [member](#) is performing a service for a [financial statement](#) audit or review [client](#) of the [firm](#), or a component of a *financial statement* audit or review *client* of the *firm*, the *member* should communicate the non-compliance or suspected non-compliance within the *firm*. The communication should be made in accordance with the *firm's* protocols or procedures or, in the absence of such protocols and procedures, directly to the audit or review engagement [partner](#).
- .32 If the [member](#) is performing a service for a [financial statement](#) audit or review [client](#) of a [network firm](#), or a component of a *financial statement* audit or review *client* of a *network firm*, the *member* should consider whether to communicate the non-compliance or suspected non-compliance to the *network firm*. If the communication is made, it should be made in accordance with the [network's](#) protocols or procedures or, in the absence of such protocols and procedures, directly to the audit or review engagement [partner](#).
- .33 If the [member](#) is performing a service for a [client](#) that is not a [financial statement](#) audit or review *client* of the [firm](#), except as required by law or regulation, the *member* is not permitted to communicate the non-compliance or suspected non-compliance to the *firm* that is the *client's* external auditor, if one exists. See the ["Confidential Client Information Rule"](#) [1.700.001].
- .34 In all cases, the communication is to enable the audit or review engagement [partner](#) to be informed about the non-compliance or suspected non-compliance and to determine whether it should be addressed in accordance with the provisions of this interpretation and if so, how.

Documentation

- .35 In relation to an identified or suspected act of non-compliance that falls within the scope of this interpretation, the [member](#) should, in addition to complying with the documentation requirements under applicable professional standards, document the following:
- a. The matter
 - b. The results of discussion with management and, where applicable, [those charged with governance](#) and other parties
 - c. How management and, where applicable, *those charged with governance* have responded to the matter

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- d. The courses of action the *member* considered, the judgments made and the decisions that were taken, having regard to the reasonable and informed third party perspective

Text of Proposed New Interpretation “Responding to Non-Compliance with Laws and Regulations”

(Applicable to Members in Public Practice)

[Terms in italic only are defined terms]

2.170 Responding to Non-Compliance with Laws and Regulations

2.170.010 Responding to Non-Compliance with Laws and Regulations

Introduction

Applicable to All Members in Business

- .01 When a *member in business* encounters or is made aware of non-compliance or suspected non-compliance with laws and regulations in the course of carrying out *professional services, threats* to compliance with the “Integrity and Objectivity Rule” [2.100.010} may exist. The purpose of this interpretation is to set out the *member’s* responsibilities when encountering such non-compliance or suspected non-compliance and guide the *member* in assessing the implications of the matter and the possible courses of action when responding to it. This interpretation applies regardless of the nature of the *employing organization*.
- .02 Non-compliance with laws and regulations (non-compliance) comprises acts of omission or commission, intentional or unintentional, committed by the *member’s employing organization* or by *those charged with governance*, by management, or by other individuals working for or under the direction of the *employing organization* which are contrary to the prevailing laws or regulations.
- .03 When responding to non-compliance or suspected non-compliance in the course of carrying out *professional services*, the *member* should consider the *member’s* obligations under the “Confidential Information Obtained from Employment or Volunteer Activities” interpretation [2.400.070]. For example, a *member* should not disclose the non-compliance or suspected non-compliance to a third party without the employer’s consent unless expressly permitted under the “Confidential Information Obtained from Employment or Volunteer Activities” interpretation, such as when reporting the non-compliance or suspected non-compliance to a regulatory authority in order to comply with applicable laws and regulations, as discussed in paragraph .04.
- .04 Some regulators, for example, the SEC or state boards of accountancy, may have provisions governing how *members* should address non-compliance or suspected non-compliance which may differ from or go beyond this interpretation, and state and federal civil and criminal laws, in some circumstances, may impose additional requirements. When encountering such non-compliance or suspected non-compliance, the *member* has a responsibility to obtain an understanding of those provisions and comply with them, including any requirement to report the matter to an appropriate authority and any prohibition on alerting the relevant party prior to making any disclosure, for example, pursuant to anti-money laundering legislation.

.05 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 member are as follows:

- a. To comply with the “Integrity and Objectivity Rule” [2.100.010]
- b. To alert management or, if appropriate, those charged with governance of the employing organization, to enable them to
 - i. 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
- c. To take such further action as appropriate in the public interest

Scope

.06 This interpretation sets out the approach to be taken by a member who encounters or is made aware of non-compliance or suspected non-compliance with the following:

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

.07 Examples of laws and regulations which this interpretation addresses include those that deal with the following:

- a. Fraud, corruption, and bribery
- b. Money laundering
- c. Securities markets and trading
- d. Banking and other financial products and services
- e. Data protection

- f. Tax and pension liabilities and payments
- g. Environmental protection
- h. Public health and safety

.08 Non-compliance may result in fines, litigation or other consequences for the [employing organization](#) that may have a material effect on its [financial statements](#). Importantly, such non-compliance may have wider public interest implications in terms of potentially substantial harm to 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.

.09 A [member](#) who encounters or is made aware of matters that are clearly inconsequential, judged by their nature and their impact, financial or otherwise, on the [employing organization](#), its stakeholders and the general public, is not required to comply with this interpretation with respect to such matters.

.10 This interpretation does not address the following:

- a. Personal misconduct unrelated to the business activities of the [employing organization](#)
- b. Non-compliance other than by the *employing organization* or [those charged with governance](#), management, or other individuals working for or under the direction of the *employing organization*

The [member](#) may 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

.11 It is the responsibility of the [employing organization's](#) management, with the oversight of [those charged with governance](#), to ensure that the *employing organization's* business activities are conducted in accordance with laws and regulations. It is also the responsibility of management and [those charged with governance](#) to identify and address any non-compliance by the *employing organization* or by an individual charged with governance of the entity, by a member of management, or by other individuals working for or under the direction of the *employing organization*.

Responsibilities of Members in Business

.12 Many [employing organizations](#) have established protocols and procedures (for example, an ethics policy or internal whistle-blowing mechanism) regarding how non-compliance or

suspected non-compliance by the *employing organization* should be raised internally. Such protocols and procedures may allow for matters to be reported anonymously through designated channels. If these protocols and procedures exist within the *member's employing organization*, the *member* should consider them in determining how to respond to such non-compliance.

- .13 If a *member* becomes aware of a matter to which this interpretation applies, the steps that the *member* takes to comply with this section shall be taken on a timely basis, having regard to the *member's* understanding of 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 Members who are Senior Professional Accountants in Business

- .14 *Members* who are senior professional accountants in business are directors, officers, or senior employees able to exert significant influence over, and make decisions regarding, the acquisition, deployment and control of the *employing organization's* human, financial, technological, physical and intangible resources. Because of their roles, positions, and spheres of influence within the *employing organization*, there is a greater expectation for them to take whatever action is appropriate in the public interest to respond to non-compliance or suspected non-compliance than other professional accountants within the *employing organization*.

Obtaining an Understanding of the Matter

- .15 If, in the course of carrying out *professional services*, a *member* who is a senior professional accountant becomes aware of information concerning an instance of non-compliance or suspected non-compliance, the *member* should obtain an understanding of the matter, including the following:
- a. The nature of the act and the circumstances in which it has occurred or may occur
 - b. The application of the relevant laws and regulations to the circumstances
 - c. The potential consequences to the *employing organization*, investors, creditors, employees or the wider public
- .16 A *member* who is a senior professional accountant is expected to apply knowledge, professional judgment and expertise, but is not expected to have a level of understanding of laws and regulations beyond that required for the *member'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.
- .17 Depending on the nature and significance of the matter, the *member* may cause, or take appropriate steps to cause, the matter to be investigated internally. The *member* may also consult on a confidential basis with others within the *employing organization* or a professional body or with legal counsel.

Addressing the Matter

- .18 If the [member](#) who is a senior professional accountant identifies or suspects that non-compliance has occurred or may occur, the *member* should, subject to paragraph .12, discuss the matter with the *member's* immediate superior, if any, to determine how the matter should be addressed. If the *member's* immediate superior appears to be involved in the matter, the *member* should discuss the matter with the next higher level of authority within the [employing organization](#).
- .19 The [member](#) who is a senior professional accountant should also take the following appropriate steps:
- a. Have the matter communicated to [those charged with governance](#) to obtain their concurrence regarding appropriate actions to take to respond to the matter and to enable them to fulfill their responsibilities.
 - b. Comply with applicable laws and regulations, including legal or regulatory provisions governing the reporting of non-compliance or suspected non-compliance 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
 - e. Seek to deter the commission of the non-compliance if it has not yet occurred
- .20 In addition to responding to the matter in accordance with the provisions of this interpretation, the [member](#) who is a senior professional accountant should determine whether disclosure of the matter to the [employing organization's](#) external auditor, if any, is necessary pursuant to the *member's* duty or legal obligation to provide all information necessary to enable the auditor to perform the audit. See the "[Obligation of a Member to His or Her Employer's External Accountant](#)" [2.130.030] interpretation for additional guidance.

Determining Whether Further Action Is Necessary

- .21 The [member](#) who is a senior professional accountant should assess the appropriateness of the response of the *member's* superiors, if any, and [those charged with governance](#).
- .22 Relevant factors to consider in assessing the appropriateness of the response of the [member's](#) superiors, if any, and [those charged with governance](#) include whether
- a. the response is timely.

- b. 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.
- c. the matter has been disclosed to an appropriate authority where appropriate and, if so, whether the disclosure appears adequate.

.23 In light of the response of the member's superiors, if any, and those charged with governance, the *member* should determine if further action is necessary in the public interest. The determination of whether further action is necessary, and the nature and extent of it, will depend on various factors, including these:

- a. The legal and regulatory framework
- b. The urgency of the matter
- c. The pervasiveness of the matter throughout the employing organization
- d. Whether the *member* who is a senior professional accountant continues to have confidence in the integrity of the *member's* superiors and those charged with governance
- e. Whether the non-compliance or suspected non-compliance is likely to recur
- f. 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

.24 Examples of circumstances that may cause the member who is a senior professional accountant no longer to have confidence in the integrity of the *member's* superiors and those charged with governance include such situations as these:

- a. The *member* suspects or has evidence of management's involvement or intended involvement in any non-compliance.
- b. Contrary to legal or regulatory requirements, management has not reported the matter, or authorized the matter to be reported, to an appropriate authority within a reasonable period.

.25 In determining the need for, and nature and extent of any further action necessary, the member who is a senior professional accountant should exercise professional judgment and take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances available to the *member* at the time, would be likely to conclude that the *member* has acted appropriately in the public interest.

.26 Further action by the [member](#) who is a senior professional accountant may include the following:

- a. Informing the management of the parent entity of the matter if the [employing organization](#) is a *member* of a group
- b. Resigning from the *employing organization*

.27 When the [member](#) who is a senior professional accountant determines that resigning from the [employing organization](#) would be appropriate, doing so would not be a substitute for taking other actions that may be necessary to achieve the *member's* objectives under this section.

.28 As consideration of the matter may involve complex analysis and judgments, the [member](#) who is a senior professional accountant may consider consulting internally, obtaining legal advice to understand the *member's* options and the professional or legal implications of taking any particular course of action or consulting on a confidential basis with a regulator or professional body.

Documentation

.29 In relation to an identified or suspected act of non-compliance that falls within the scope of this interpretation, the [member](#) who is a senior professional accountant is encouraged to have the following matters documented:

- a. The matter
- b. The results of discussions with the *member's* superiors, if any, and [those charged with governance](#) and other parties
- c. How the *member's* superiors, if any, and [those charged with governance](#) have responded to the matter
- d. The courses of action the *member* considered, the judgments made and the decisions that were taken
- e. How the *member* is satisfied that the *member* has fulfilled the responsibility set out in paragraph .23

Responsibilities of Members Other Than Those Who Are Senior Professional Accountants in Business

.30 If, in the course of carrying out [professional services](#), a [member](#) becomes aware of information concerning an instance of non-compliance or suspected non-compliance, the *member* should seek to obtain an understanding of the matter, including the nature of the act and the circumstances in which it has occurred or may occur.

- .31 The [member](#) is expected to apply knowledge, professional judgment, and expertise, but is not expected to have a level of understanding of laws and regulations beyond that required for the *member'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. Depending on the nature and significance of the matter, the *member* may consult on a confidential basis with others within the *employing organization* or a professional body, or with legal counsel.
- .32 If the [member](#) identifies or suspects that non-compliance has occurred or may occur, the *member* should, subject to paragraph .12, inform an immediate superior to enable the superior to take appropriate action. If the *member's* immediate superior appears to be involved in the matter, the *member* should inform the next higher level of authority within the [employing organization](#).
- .33 In addition to responding to the matter in accordance with the provisions of this interpretation, the [member](#) should determine whether disclosure of the matter to the [employing organization's](#) external auditor, if any, is necessary pursuant to the *member's* duty or legal obligation to provide all information necessary to enable the auditor to perform the audit. See the "[Obligation of a Member to His or Her Employer's External Accountant](#)" interpretation [2.130.030] for additional guidance.

Documentation

- .34 In relation to an identified or suspected act of non-compliance that falls within the scope of this interpretation, the [member](#) is encouraged to have the following matters documented:
- a. The matter
 - b. The results of discussions with the *member's* superior, management and, where applicable, [those charged with governance](#) and other parties
 - c. How the *member's* superior has responded to the matter
 - d. The courses of action the *member* considered, the judgments made and the decisions that were taken