



# Exposure draft

Proposed interpretations and definition

Responding to Noncompliance With Laws and Regulations

**AICPA Professional Ethics Division**  
**February 25, 2021**

**Comments are requested by June 30, 2021**

Prepared by the AICPA Professional Ethics Executive Committee for comments from those interested in independence, behavioral, and technical standards. Please address comments to [Ethics-Exposuredraft@aicpa.org](mailto:Ethics-Exposuredraft@aicpa.org).

*Copyright © 2021 by  
American Institute of Certified Public Accountants, Inc.  
New York, NY 10036-8775*

Permission is granted to make copies of this work provided that such copies are for personal, intra-organizational, or educational use only and are not sold or disseminated and provided further that each copy bears the following credit line: “Copyright © 2021 by the American Institute of Certified Public Accountants, Inc. Used with permission.”

February 25, 2021

If you're an AICPA member or someone interested in the ethics of auditing and accounting, we want to hear your thoughts on this ethics exposure draft!

This proposal is part of the AICPA's Professional Ethics Executive Committee (PEEC) project to converge with the standards of the International Ethics Standards Board for Accountants (IESBA), specifically sections 260 and 360, *Responding to Non-Compliance with Laws and Regulations*.

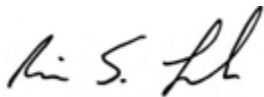
This exposure draft is an explanation of the proposed pronouncement and the full text of the guidance being considered.

After the exposure period concludes and PEEC has evaluated the comments, PEEC may decide to publish the new interpretations.

Your comments are an important part of the standard-setting process; please take this opportunity to comment. Responses must be received at the AICPA by June 30, 2021. All written replies to this exposure draft will become part of the public record of the AICPA and will be available at [www.aicpa.org/peecprojects](http://www.aicpa.org/peecprojects). PEEC will consider comments at its subsequent meetings.

Please email comments to [Ethics-ExposureDraft@aicpa.org](mailto:Ethics-ExposureDraft@aicpa.org).

Sincerely,



Brian S. Lynch, Chair  
Professional Ethics Executive Committee



Toni Lee-Andrews, Director, CPA, PFS, CGMA  
Professional Ethics Division

## **Professional Ethics Executive Committee (2020–2021)**

Brian S. Lynch, *Chair*

Catherine Allen

Christopher Cahill

Thomas Campbell

Robert E. Denham

Anna Dourdourekas

Anika Heard

Kelly Hunter

Sharon Jensen

Jennifer Kary

Jefferey Lewis

G. Alan Long

William McKeown

James Newhard

Stephanie Saunders

Lewis Sharpstone

Lisa Snyder

Peggy Ullmann

Douglas E. Warren

Lawrence A. Wojcik

### **NOCLAR Task Force**

Robert E. Denham, *Chair*

J. Coalter Baker

Samuel L. Burke

Brian S. Lynch

Bill Mann

Elizabeth Pittelkow Kittner

Stephanie Saunders

Lisa Snyder

### **Project staff**

James W. Brackens, Jr., CPA, CGMA, Vice President — Ethics & Practice Quality

Toni T. Lee-Andrews, CPA, PFS, CGMA, Director — Professional Ethics

Ellen T. Gorla, CPA, Associate Director Global — Professional Ethics

Michele Craig, Lead Manager — Professional Ethics

# Contents

---

	Page
Explanation for the new interpretations "Responding to Noncompliance With Laws and Regulations" .....	6
Text of proposed interpretations "Responding to Noncompliance With Laws and Regulations" (applicable to members in public practice) .....	18
Text of proposed interpretations "Responding to Noncompliance With Laws and Regulations" (applicable to members in business) .....	31
Text of proposed new definition "Financial Statement Attest Services" .....	40
Text of proposed revised interpretation "Ethical Conflicts" .....	41

# Explanation for the new interpretations “Responding to Noncompliance With Laws and Regulations”

The Professional Ethics Executive Committee (PEEC) is re-exposing for comment two new interpretations, each entitled “Responding to Noncompliance With Laws and Regulations.” If adopted as final, the new interpretations will be in ET sections 1.170.010 and 2.170.010 of the AICPA Code of Professional Conduct<sup>1</sup> (the AICPA code), applicable to members in public practice and in business, respectively.

## I. Purpose

1. As part of its international convergence efforts, on March 10, 2017, PEEC issued for comments an exposure draft proposing two new interpretations entitled “Responding to Noncompliance With Laws and Regulations” under the “Integrity and Objectivity Rule.” In developing the proposed interpretations, PEEC considered the International Ethics Standards Board for Accountants’ (IESBA’s) new ethics standards, sections 260 and 360, each entitled *Responding to Non-Compliance with Laws and Regulations*.<sup>2</sup> PEEC believes that though many of the proposed requirements were already consistent with those of the IESBA Code of Ethics for Professional Accountants (IESBA code), certain modifications are necessary to enhance the clarity of the proposed interpretations and make them relevant to AICPA members in the United States.
2. The AICPA code does not currently provide specific guidance for members who encounter noncompliance 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 acronym NOCLAR covers both actual NOCLARs and suspected NOCLARs.
3. The general objective of members who encounter a NOCLAR is to alert the appropriate parties 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.

## II. Scope

4. The interpretations state that a NOCLAR comprises acts of omission or commission — intentional or unintentional — contrary to the prevailing laws or regulations that are committed by a client, an employer, or those charged with governance, by management, or by other individuals working for or under the direction of a client or employer. 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

---

<sup>1</sup> All ET sections can be found in AICPA *Professional Standards*.

<sup>2</sup> Approved in April 2016 for inclusion in the IESBA’s Code of Ethics for Professional Accountants.

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 with those laws may be fundamental to the operating aspects of the business of the client or employing organization, to its ability to continue business, or its ability to avoid material penalties. The interpretations do not address personal misconduct unrelated to the business activities of the client or employing organization.

5. 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 understanding of laws and regulations necessary for the [professional service](#) for which the member was engaged or was employed to perform. In addition, for members performing audit services for a client, the proposed guidance imposes ethical requirements that are separate from any audit or other applicable standards. The proposals are not intended to modify or interpret AU-C section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*.<sup>3</sup>

### III. Background

#### *Original proposed interpretations*

6. As noted earlier, PEEC is re-exposing its interpretations. The original proposal set forth the following:
  - a. The proposed NOCLAR requirements for members in public practice were generally the same for members who provide attest services and those who provide nonattest services to clients.
  - b. When performing professional services for a component of a group during a group attest engagement, a member in public practice would be required to respond to a NOCLAR by communicating it to the group engagement partner, unless prohibited by law or regulation.
  - c. When 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 would be required to communicate a NOCLAR within the firm in accordance with the firm's policies and procedures. When 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 without the client's consent.
  - d. A member who is a senior professional accountant in business would be required to take certain steps, including communicating to those charged with governance. The

---

<sup>3</sup> All AU-C sections can be found in AICPA *Professional Standards*.

goal would be to obtain concurrence regarding the appropriate actions that would enable those charged with governance to fulfill their responsibilities.

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

### ***Exposure draft feedback***

7. PEEC received 17 comment letters on the original proposal. Most commenters had objections to various aspects of the exposure draft. The principal concerns identified in the comment letters related to members' professional obligation to comply with confidentiality requirements and the practical challenges and competitive disadvantages the proposed interpretations would impose on members performing nonattest services. Specifically, some expressed concerns that the proposed language would discourage CPAs from acting in the public interest, even after the CPA demonstrated compliance with all relevant professional standards. Others did not support the original proposal because the interpretation for members in public practice did not differentiate requirements for those performing attest services and those performing nonattest services.

## **IV. Revisions to original proposal**

8. Based on comments received and further discussion of the issues, PEEC has made a number of changes to the originally proposed interpretations. The substantive changes to the original proposal are summarized as follows.

### ***Revisions to the originally proposed interpretation applicable to members in public practice***

#### **Separate requirements for members in public practice**

9. Certain commenters believed that the original proposal was not consistent with IESBA's provision for professional services other than audits of financial statements and that it did not sufficiently recognize differences between auditors and non-auditors (attestation and non-attestation services). To address these comments, PEEC bifurcated the guidance for members in public practice, so that there are now separate requirements for members providing financial statement attest services and members providing services other than financial statement attest services.

#### ***Members providing financial statement attest services***

10. PEEC considered whether the same requirements should apply for all attest services, or whether additional steps should be required for certain attest services such as financial



statement audit and review services. PEEC decided that the requirements should be more stringent for financial statement attest services and now proposes using the term *financial statement attest services* throughout the proposed interpretation. This term is not specifically defined in the AICPA code, so PEEC will add a definition for *financial statement attest services* to the “Definitions” section (ET sec. 0.400). The AICPA code defines the term *financial statement attest client*.

11. Specifically, for financial statement attest services, when a member in public practice discovers a NOCLAR, the member will be required to obtain an understanding of the matter, including the nature of the act and the circumstances surrounding its occurrence. After obtaining an understanding, the member would then be required to discuss the matter with the appropriate level of management and, if appropriate, those charged with governance. 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. If the member determines that management’s response was not appropriate, the member is required to consider withdrawing from the engagement, unless prohibited by law or regulation.

#### *Members providing services other than financial statement attest services*

12. PEEC considered the requirements for members providing services other than financial statement attest services and has added guidance to the proposed interpretation that is consistent with IESBA’s guidance for professional accountants providing nonattest services.
13. For example, members providing such services would only be required to seek to obtain an understanding of the matter. Addressing the matter would be limited to communicating the matter to the appropriate level of management and those charged with governance, if the member has access to them, whereas members providing financial statement attest services are also required to “advise management to take specified appropriate and timely actions” when addressing a NOCLAR. Additionally, members providing services other than financial statement attest services would be encouraged to document, rather than be required to document, certain aspects of the NOCLAR.

### ***Applicability***

#### *Use of the term client*

14. PEEC discussed the responsibility a member would have to report a NOCLAR if the subject entity is not the entity that engaged the member, as well as the use of the term *client* throughout the proposed interpretation. PEEC noted that the IESBA code (paragraph 360.7A3) does not impose responsibility with respect to reporting to management of parties not identified in its guidance, such as a third party that is the subject of due diligence

performed by a member. PEEC decided that the member's responsibility throughout the proposed interpretation should be exclusively to the *engaging entity* if not the same as the *subject entity*. PEEC therefore added an explanation in paragraph .01 that, if the subject entity and engaging entity are different, the term *client* refers to the engaging entity. PEEC also added language in paragraph .06b clarifying that the interpretation is not applicable to noncompliance by parties other than the client. Thus, for example, if a member is engaged by an attorney or underwriter to perform services on a third party, the interpretation will not be applicable to a NOCLAR committed by the third party.

#### *Exclusion of certain nonattest services*

15. Based on the review of services that were the subject of comments on the original proposal, PEEC has carved out certain nonattest services from the proposed interpretation applicable to members in public practice. Specifically, the interpretation will not be applicable to a litigation or investigation engagement as defined in, and subject to, the AICPA's Statement on Standards for Forensic Services (SSFS) No. 1 (FS sec. 100).<sup>4</sup> This is because the member often is engaged to perform such services specifically to address a known or suspected NOCLAR, and compliance with the interpretation would be inconsistent with the structure and purpose of the engagement and the applicability of various privileges.
16. SSFS No. 1 defines *litigation* and *investigation* engagements as follows:
  - a. **Litigation.** An actual or potential legal or regulatory proceeding before a trier of fact or a regulatory body as an expert witness, consultant, neutral mediator, or arbitrator in connection with the resolution of disputes between parties. The term *litigation* as used herein is not limited to formal litigation but is inclusive of disputes and all forms of alternative dispute resolution.
  - b. **Investigation.** A matter conducted in response to specific concerns of wrongdoing in which the member is engaged to perform procedures to collect, analyze, evaluate, or interpret certain evidential matter to assist the stakeholders (for example, client, board of directors, independent auditor, or regulator) in reaching a conclusion on the merits of the concerns.
17. PEEC also considered tax engagements in which there may be applicable privileges that should be retained and would therefore be inconsistent with NOCLAR requirements, such as *client privilege* and *Kovel arrangements*.<sup>5</sup> PEEC decided to specifically carve out tax services pursuant to the protection of Internal Revenue Code (IRC) Section 7525 (client privilege) in paragraph .06d of the proposed interpretation. PEEC did not specifically exclude Kovel arrangements because these engagements are not defined by AICPA standards or by any other professional standard or regulation. However, PEEC believes that, based on the nature of these engagements, Kovel arrangements could, depending on

---

<sup>4</sup> All FS sections can be found in AICPA *Professional Standards*.

<sup>5</sup> U.S. vs. Kovel (296.F.2d 918(2d Cir.1961)).

their circumstances, be excluded under the proposed interpretation's guidance provided for forensic accounting engagements documented in paragraph .06c. Moreover, this interpretation would generally not apply to Kovel arrangements in which a law firm is the client because the interpretation does not apply to noncompliance by parties other than the client, as discussed in paragraph 14.

### **Confidentiality**

18. Due to state laws and regulations protecting client confidentiality, the original proposal did not contain provisions that would require a member who has withdrawn from a professional relationship to disclose a NOCLAR, including to the successor accountant when there is an information request by the successor accountant.
19. Certain commenters believed that the originally proposed interpretation was too restrictive on NOCLAR disclosure. PEEC believes that it is in the public interest for an auditor who is aware of a NOCLAR to be able to communicate the NOCLAR to the successor auditor. The "Confidential Client Information Rule" (ET sec. 1.700.001) would prohibit such disclosure without the client's consent unless the communication met one of the specified exceptions set forth in the rule, which includes compliance with professional standards. Accordingly, on October 22, 2019, PEEC voted to request the Auditing Standards Board (ASB) to modify its current standards and consider requiring communication between predecessor and successor auditors if, at the time of termination of the assurance engagement, the predecessor auditor was aware of the client's NOCLAR. The ASB accepted PEEC's request to consider this matter. PEEC revised paragraphs .03, .05d, and .21biv of the proposed interpretation to emphasize the member's requirement to comply with standards in accordance with the ASB's possible revision to its standards.
20. In the ASB's proposed amendment to AU-C section 210, *Terms of Engagement*, the predecessor auditor will continue to be required to obtain specific consent from the client before discussing matters involving NOCLAR with the successor auditor. However, the ASB's proposed revisions to its standards include adding a requirement for a successor auditor to make specific inquiries to the predecessor auditor regarding identified or suspected fraud and matters involving NOCLAR once management provides authorization to the predecessor auditor to respond to the successor's inquiries. The proposed amendment will also require the predecessor auditor to respond fully and timely and to indicate if the response is limited, as may occur, for example, if the predecessor auditor decides not to fully respond to the successor auditor after receiving the client's authorization due to impending, threatened, or potential litigation; disciplinary proceedings; or other unusual circumstances. For additional information on the proposed amendment, please review the ASB's exposure draft "[Proposed Statement on Auditing Standards, \*Inquiries of the Predecessor Auditor Regarding Fraud and Noncompliance With Laws and Regulations\*](#)."

21. PEEC believes that, regardless of any changes the ASB ultimately makes to its standards, the “Disclosing Information From Previous Engagements” interpretation (ET sec. 1.700.020) of the “Confidential Client Information Rule” directs members to give careful consideration to situations in which the member withdraws from an engagement due to a NOCLAR. If a member withdraws from an engagement due to discovery of irregularities at a client and the member is contacted by a successor auditor, the member should tell the successor auditor to obtain client consent to allow the member to discuss all matters freely with the successor auditor, which should put the successor auditor on notice of a potential issue (paragraph .02 of ET sec. 1.700.020). Additionally, paragraph .03 of the interpretation specifically states that the “Confidential Client Information Rule” “is not intended to help an unscrupulous client cover up illegal acts or otherwise hide information by changing CPAs,” and strongly encourages members to seek legal advice in connection with any such circumstances.
22. Some commenters believed that the interpretation should go further and require reporting of a NOCLAR to an outside authority. PEEC considered these comments but still believes that disclosure of a NOCLAR to a third party without the client’s consent is inconsistent with client confidentiality laws and regulations except in certain instances where already required by law. However, PEEC will continue to evaluate whether there are any circumstances, besides those that exist under the current provisions of the AICPA code and state laws and regulations, in which reporting of a NOCLAR to an outside authority should be further considered.

***Revisions to the originally proposed interpretation applicable to members in business***

*Confidentiality*

23. PEEC believes it would be in the public interest for members in business to have the ability to communicate a NOCLAR to an appropriate authority and, unlike the “Confidential Client Information Rule” applicable to members in public practice, the “Confidential Information Obtained From Employment or Volunteer Activities” interpretation (ET sec. 2.400.070) of the “Acts Discreditable Rule” (ET sec. 2.400.001) permits a member in business to disclose confidential employer information if “there is a professional responsibility or right to disclose information, when not prohibited by law, to ... comply with professional standards and other ethics requirements.” PEEC therefore agreed to revise the proposed interpretation to allow both senior professional accountants in business and other professional accountants in business to report a NOCLAR to a regulatory body. Accordingly, PEEC added paragraphs .25c and .34 to indicate that a member may report a NOCLAR to an appropriate authority unless prohibited by laws or regulations. Factors that members would consider when determining whether to disclose a NOCLAR to an appropriate authority, such as when protection exists under whistleblowing legislation or regulations, were also added as paragraph .27.

## V. Other clarifications

24. PEEC is proposing a number of clarifications to the original proposal. PEEC believes these clarifications do not change the substance of the requirements in the original proposal; rather, they will assist members with operationalizing the requirements. The following summarizes significant clarifications included in the revised proposal.

### ***Members in public practice***

#### *Geography*

25. PEEC revised the geography of the proposed interpretation applicable to members in public practice and added a new section, “Applicability,” to provide clear guidance on situations to which the interpretation would not apply.

#### *Communication with respect to group engagements*

26. Under the “Communication With Respect to Group Auditor” section, PEEC replaced the term *group attest engagement* with *group audit engagement*, as the Statements on Standards for Attestation Engagements (SSAEs) do not refer to group engagements. PEEC also noted that the member has a requirement to communicate a NOCLAR to the group audit partner in accordance with professional standards (that is, AU-C section 600, *Special Considerations — Audits of Group Financial Statements [Including the Work of Component Auditors]*). PEEC believes the requirement in the professional standards sufficiently addresses this matter and added language to the proposed interpretation referencing the professional standards.

27. PEEC also removed the language under this section related to statutory audits, as a member being engaged to perform a component audit for purposes of a statutory audit is not common in the United States.

#### *Clearly inconsequential*

28. PEEC revised paragraph .10 of the proposed interpretation as it relates to the term *clearly inconsequential* for consistency with ASB standards (AU-C sec. 210 and AU-C sec. 250). The ASB does not define *clearly inconsequential*. PEEC will not define this term either, in order to avoid any possible conflict with the ASB’s standards.

#### *Credible information*

29. PEEC considered the sources of information, such as *other parties*, concerning an instance of a NOCLAR. PEEC concluded that adding the term *credible* was appropriate to further clarify the level of information obtained by the member, whether the member directly obtains such information during the engagement or indirectly through other sources.

### *Occurrence*

30. PEEC replaced the term *may occur* with the phrase *is likely to occur*. PEEC believes that the former term was too broad.

### *Access to management*

31. PEEC deleted the phrase *if the member has access to them* as it relates to discussing a NOCLAR with the appropriate level of management; PEEC believes that a member will likely have access to such individuals when providing financial statement attest services. This term remains included in the guidance for members providing services other than financial statement attest services in which a member, depending on the nature of the engagement, might not have access to the appropriate level of management.

### ***Members in business***

#### *Disclosing a NOCLAR to the external auditor*

32. PEEC clarified the language in paragraphs .20 and .33 applicable to members in business to require both senior professional accountants in business and other professional accountants in business to disclose a NOCLAR to the external auditor if the member determines such disclosure is necessary pursuant to the member's obligation to provide all information necessary to enable the auditor to perform the audit. PEEC believes the language in the original proposal may have been ambiguous or may have conflicted with the "Obligation of a Member to His or Her Employer's External Accountant" interpretation (ET sec. 2.130.030) under the "Preparing and Reporting Information Rule" (ET sec. 2.130).
33. PEEC also deleted the phrase *duty or legal* because the AICPA code does not define the term *duty* and the preceding paragraphs in the proposed interpretations require members to comply with laws and regulations. This revision would leave flexibility for whistleblowing protection.

#### *Clearly inconsequential*

34. PEEC revised paragraph .09 of the proposed interpretation as it relates to the term *clearly inconsequential* for consistency with the revision to paragraph .10 of the proposed interpretation for members in public practice.

## ***Members in public practice and members in business***

### *Professional judgment*

35. For both members in public practice and members in business, to avoid redundancy and vaguely worded requirements, PEEC removed language related to a member exercising his or her professional judgment in determining the need to withdraw from an engagement, as compliance with all elements of this interpretation requires the exercise of professional judgment.

## **VI. Consideration of other comments**

### ***Members in public practice***

#### *Communication and documentation*

36. A commenter recommended that PEEC include specific thresholds for communicating and documenting instances of NOCLAR in the proposed interpretation for members in public practice. PEEC considered this comment and decided not to include thresholds for communicating and documenting instances of NOCLAR, as it would be impossible to identify the many potential scenarios to establish a single threshold. Rather, PEEC believes each situation needs to be evaluated based on its own facts and circumstances.

#### *Noncompliance or suspected noncompliance*

37. PEEC received a comment recommending that PEEC clarify the phrase *noncompliance or suspected noncompliance* used throughout the proposed interpretations. Additionally, PEEC was asked to include explicit language specifying that members are neither required nor expected to perform additional procedures designed to detect NOCLARs. PEEC considered this comment and concluded that the language in the interpretation is consistent with IESBA and did not believe that further clarification of this phrase was necessary. PEEC believes that the term *made aware* in paragraph .01 is clear and implies that additional procedures are not required. Accordingly, PEEC believes explicit language is not necessary regarding detection of NOCLARs and did not want to create potential inconsistencies with other professional standards applicable to illegal acts.

#### *Client's understanding of legal or regulatory responsibilities*

38. PEEC was asked to provide guidance regarding the procedures expected to be performed by the member to consider the client's understanding of its legal or regulatory responsibilities. PEEC believes that the proposed guidance is clear about the fact that the member may advise the client to obtain legal advice if it is clear to the member that the client

does not understand the applicable laws and regulations and that the member will not be providing legal advice in complying with the proposed interpretation.



## VII. Revisions to other interpretations in the AICPA code

39. PEEC added references to the NOCLAR interpretations in the “Confidential Information Obtained from Employment or Volunteer Activities” interpretations (ET sec. 1.400.070 and 2.400.070) and “Subordination of Judgment” (ET sec.1.130.020 and 2.130.020) interpretations for consistency in the AICPA code.
40. The “Ethical Conflicts” interpretation (ET sec. 1.000.020) of the “Introduction” section (ET sec. 1.000) for members in public practice provides an example to members to clarify that if a member suspects that a fraud may have occurred, the member would violate the client’s confidentiality if the member reports the suspected fraud. PEEC will remove this example because the proposed NOCLAR interpretation for members in public practice more specifically addresses this situation and will add a reference to the NOCLAR interpretation.

### Effective date

41. PEEC recommends that the proposal be effective one year after notice is published in the *Journal of Accountancy*.

### ***Request for comments***

42. PEEC welcomes comments on all aspects of the proposed revisions. In addition, PEEC is seeking feedback on the following specific aspects of the proposed interpretations:
- a. Do you agree with the differentiation in requirements applicable to members in public practice providing services other than financial statement attest services?
  - b. Do you agree that a litigation or investigation engagement as defined in, and subject to, SSFS No. 1, and an engagement to which the protections set forth in IRC Section 7525 apply, should be excluded from the proposed interpretation for members in public practice? If not, why? Are there other nonattest services that should be excluded from the proposed interpretation? If yes, please identify which services and explain why.
  - c. Is a one-year transition period for the effective date appropriate? If not, why?

## Text of proposed interpretation “Responding to Noncompliance With Laws and Regulations” (applicable to members in public practice)

(Additions made since the March 10, 2017, exposure draft are presented in ***bold italic text***. Deletions are presented in ~~strikethrough~~.)

### ***1.170. Responding to Noncompliance With Laws and Regulations***

#### ***1.170.010 Responding to Noncompliance With Laws and Regulations***

##### ***Introduction***

- .01*** When a [member](#) encounters or is made aware of noncompliance or suspected noncompliance 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 noncompliance or suspected noncompliance and guide the [member](#) in assessing ***evaluating*** the implications of the matter and the possible courses of action when responding to it. ***The [member’s](#) responsibilities in this interpretation are owed to a person or entity that engages the [member](#) or [member’s](#) firm to perform professional services (engaging entity). Therefore, when the engaging entity and subject entity are different, the term client refers to the engaging entity.***
- .02*** Noncompliance with laws and regulations (noncompliance) 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 noncompliance or suspected noncompliance 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 noncompliance or suspected noncompliance to a third party without the *client’s* consent unless expressly permitted under the “Confidential Client Information Rule,” such as when reporting the noncompliance or suspected noncompliance to a regulatory authority in order to comply with applicable laws and regulations ***or compliance with professional standards***, as discussed in paragraphs .04 and ***.05d., respectively.***
- .04*** Some regulators, such as the SEC or state boards of accountancy, may have regulatory provisions governing how a [member](#) should address noncompliance or suspected noncompliance 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 noncompliance or suspected noncompliance, 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 noncompliance or suspected noncompliance, the objectives of a [member](#) are as follows:

- 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 noncompliance or
  - ii. deter the commission of the noncompliance when 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
- d. To comply with applicable laws, regulations, and professional standards**

### **~~Scope Applicability~~**

**.06 This interpretation does not apply to the following:**

- a. Personal misconduct unrelated to the business activities of the client.**
- b. Noncompliance by parties 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 (that is, subject entity) and the identified or suspected noncompliance has been committed by that third party.**
- c. A litigation or investigation engagement as defined in the AICPA’s Statement on Standards for Forensic Services No. 1**
- d. An engagement pursuant to which the protections set forth in Internal Revenue Code Section 7525 may apply**

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

## **Scope**

**.07** This interpretation sets out the approach to be taken by a member who encounters or is made aware of noncompliance or suspected noncompliance 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

**.08** 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

**.09** Noncompliance may result in fines, litigation, or other consequences for the *client* that may have a material effect on its financial statements. Importantly, such noncompliance 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 nonfinancial 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.~~

~~.10 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 (**i.e., subject 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 noncompliance 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.~~

### **Members Providing Financial Statement Attest Services**

#### *Obtaining an Understanding of the Matter*

- .13 If a [member](#) engaged to perform ~~professional services~~ **financial statement attest services** becomes aware of **credible** information concerning an instance of noncompliance or suspected noncompliance, 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~~ **is likely to** 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 noncompliance 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 noncompliance has occurred or ~~may~~ **is likely to** 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 noncompliance or suspected noncompliance, 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 [audit engagement](#), the appropriate level may be management at an entity that controls the *client*.

### *Addressing the Matter*

.19 In discussing the noncompliance or suspected noncompliance 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 noncompliance.
- b. Deter the commission of the noncompliance 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, *if applicable*, [those charged with governance](#) understand their legal or regulatory responsibilities with respect to the noncompliance or suspected noncompliance. 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 noncompliance or suspected noncompliance 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 noncompliance, including fraud.
  - ii. communicating with [those charged with governance](#).
  - iii. considering the implications of the noncompliance or suspected noncompliance for **on the auditor's *audit, review, or compilation*** report.
- iv. *communicating a former client's noncompliance to the successor auditor to the extent required under professional standards.***

## Communication With Respect to Group Attest **Audit** Engagements

.22 A member may, ~~do the following:~~ **for purposes of a group audit engagement, be requested by the group engagement team to perform work on financial or other information related to a component of the group.**

- a. ~~For purposes of a group attest audit 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 **audit** engagement of a component for purposes other than the group attest **audit** engagement, for example, a statutory audit~~

If the member becomes aware of noncompliance or suspected noncompliance 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 ~~section~~, communicate **it to the group audit partner in accordance with AU-C section 600, Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)**.<sup>1</sup> ~~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 **audit** engagement partner becomes aware of noncompliance or suspected noncompliance in the course of a group attest audit engagement, including as a result of being informed of such a matter in accordance with paragraph .22, the group **audit** engagement *partner* should, in addition to responding to the matter in the context of the group attest **audit** engagement in accordance with the provisions of this interpretation ~~section~~, consider whether the matter may be relevant to one or more components **whose financial or other information is subject to procedures performed for purposes of the group audit engagement**.:

- 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 **audit** engagement *partner* should take steps to have the noncompliance or suspected noncompliance communicated to those performing work at components where the matter may be relevant, unless prohibited from doing so by law or

---

<sup>1</sup> All AU-C sections can be found in AICPA Professional Standards.



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 **evaluate** the appropriateness of the response of management and, if applicable, those charged with governance.

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

- a. the response is timely.
- b. the noncompliance or suspected noncompliance has been adequately investigated.
- c. action has been, or is being, taken to rectify, remediate, or mitigate the consequences of any noncompliance.
- d. action has been or is being taken to deter the commission of any noncompliance 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 noncompliance or suspected noncompliance has been disclosed to an appropriate authority when 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 noncompliance or suspected noncompliance 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 noncompliance.
- b. The [member](#) is aware that management has knowledge of such noncompliance 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.~~

**.29** 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.

### *Documentation*

**.30** In relation to an identified or suspected act of noncompliance that falls within the scope of this ~~interpretation~~ **section**, 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
- 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~~

### **Members Providing Services Other Than a Financial Statement Attest Service**

#### **Obtaining an Understanding of the Matter and Addressing the Matter**

- .31 If a [member](#) engaged to perform professional services other than a financial statement attest service becomes aware of credible information concerning an instance of noncompliance or suspected noncompliance, whether in the course of performing the engagement or through information provided by other parties, 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 is likely to occur.**
- .32 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 noncompliance 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.**
- .33 If the [member](#) identifies or suspects that noncompliance has occurred or is likely to 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](#).**
- .34 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.**
- .35 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*

### **Communicating the Matter to the Client's Auditor**

#### **Members Performing a Service, Other Than a Financial Statement Attest Service, for a Financial Statement Attest Client**

- .36 If the [member](#) is performing a service for ~~other than~~ a [financial statement attest](#) ~~audit or review~~ **service for a financial statement attest client** of the [firm](#) or a component of a ~~financial statement audit or review attest client~~ of the *firm*, the [member](#) should communicate the noncompliance or suspected noncompliance 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~~ **attest** engagement [partner](#).
- .37 If the [member](#) is performing a service for a ~~financial statement audit or review~~ **attest client** of a [network firm](#) or a component of a ~~financial statement audit or review attest client~~ of a [network firm](#), the [member](#) should consider whether to communicate the noncompliance or suspected noncompliance 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~~ **attest** engagement [partner](#).
- .38 In all cases, the communication is to enable the ~~audit or review~~ **attest** engagement [partner](#) to be informed about the noncompliance or suspected noncompliance and to determine whether it should be addressed in accordance with the provisions of this interpretation and, if so, how.

#### **Members Providing Services to a Client That Is Not a Financial Statement Attest Client**

- .39 If the [member](#) is performing a ~~service~~ **services** for a *client* that is not a [financial statement audit or review attest client](#) of the [firm](#), except as required by law or regulation, the [member](#) is not permitted to communicate the noncompliance or suspected noncompliance to the firm that is the client's external auditor, if one exists. See the "[Confidential Client Information Rule](#)" [1.700.001].

**Determining Whether Withdrawal From the Engagement Is Necessary**

**.40 The member should determine whether withdrawal from the engagement is necessary in the public interest.**

**.41 Whether withdrawal from the engagement is necessary will depend on various factors, including the member's understanding of the following:**

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

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

- a. The member suspects or has evidence of management's involvement or intended involvement in any noncompliance.**
- b. The member is aware that management has knowledge of such noncompliance 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.**

**. 43 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.**

### **Documentation**

**. 44 In relation to an identified or suspected act of noncompliance that falls within the scope of this section, the member is encouraged to document the following, in addition to complying with the documentation requirements under applicable professional standards:**

- 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**
- d. The courses of action the member considered, the judgments made, and the decisions that were taken**

### **Effective Date**

**.45 This interpretation is effective one year after announcement is published in the *Journal of Accountancy*.**

## Text of proposed interpretation “Responding to Noncompliance With Laws and Regulations” (applicable to members in business)

(Additions made since the March 10, 2017, exposure draft are presented in ***bold italic text***. Deletions are presented in ~~strikethrough~~.)

### ***2.170. Responding to Noncompliance With Laws and Regulations***

#### ***2.170.010 Responding to Noncompliance With Laws and Regulations***

##### ***Introduction***

##### ***Applicable to All Members in Business***

- .01** When a *member in business* encounters or is made aware of noncompliance or suspected noncompliance with laws and regulations in the course of carrying out *professional services*, *threats* to compliance with the *“Integrity and Objectivity Rule”* [2.100.001] may exist. The purpose of this interpretation is to set out the *member’s* responsibilities when encountering such noncompliance or suspected noncompliance and guide the *member* in ***assessing*** ***evaluating*** 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** Noncompliance with laws and regulations (noncompliance) 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 noncompliance or suspected noncompliance 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] of the “Acts Discreditable Rule” [2.400.001]. For example, a *member* should not disclose the noncompliance or suspected noncompliance to a third party without the employer’s consent unless expressly permitted under the “Confidential Information Obtained From Employment or Volunteer Activities” interpretation [2.400.070], such as when reporting the noncompliance or suspected noncompliance 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 noncompliance or suspected noncompliance 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 noncompliance or suspected noncompliance, 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 noncompliance or suspected noncompliance, the objectives of the member are as follows:

- a. To comply with the “Integrity and Objectivity Rule” [2.100.001]
- 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 noncompliance or
  - ii. deter the commission of the noncompliance when 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 noncompliance or suspected noncompliance 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** Noncompliance may result in fines, litigation, or other consequences for the employing organization that may have a material effect on its financial statements. Importantly, such noncompliance 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 nonfinancial 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. Noncompliance 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 noncompliance 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 whistleblowing mechanism) regarding how noncompliance or suspected noncompliance 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 noncompliance.

.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 **should** 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 noncompliance or suspected noncompliance 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 noncompliance or suspected noncompliance, 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 noncompliance 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 noncompliance 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 **to**
- 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 noncompliance or suspected noncompliance to an appropriate authority.
- c. have the consequences of the noncompliance or suspected noncompliance rectified, remediated, or mitigated.
- d. reduce the risk of reoccurrence.
- e. seek to deter the commission of the noncompliance if it has not yet occurred.

**.20** In addition to responding to the matter in accordance with the provisions of this ~~interpretation~~ **section**, the [member](#) who is a senior professional accountant should determine whether disclosure **disclose** of the matter to the [employing organization's](#) external auditor, if any, **if the member determines such disclosure** 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] of the "Integrity and Objectivity Rule" [2.100.001] for additional guidance.

### ***Determining Whether Further Action Is Necessary***

**.21** The [member](#) who is a senior professional accountant should ~~assess~~ **evaluate** the appropriateness of the response of the [member's](#) superiors, if any, and [those charged with governance](#).

**.22** Relevant factors to consider in ~~assessing~~ **evaluating** 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 noncompliance, or to avert the noncompliance 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 noncompliance or suspected noncompliance 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 noncompliance.
- 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~~ **.25** 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*

**c. Reporting the noncompliance or suspected noncompliance to an appropriate authority unless prohibited by laws or regulations**

~~.27~~.26 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~~.27 **The determination of whether to disclose the matter to an appropriate authority will also depend on external factors such as the following:**

**a. 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. Identifying an appropriate authority will depend upon the nature of the matter. For example, an appropriate authority could 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.**

**b. Whether there exists robust and credible protection from civil, criminal, or professional liability or retaliation afforded by legislation or regulation, such as under whistleblowing legislation or regulation.**

**c. Whether there are actual or potential threats to the physical safety of the senior professional accountant or other individuals.**

.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 noncompliance that falls within the scope of this interpretation **section**, 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 noncompliance or suspected noncompliance, 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 noncompliance 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 noncompliance 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 **section**, the [member](#) should determine whether to ~~disclose~~ **disclose** of the matter to the [employing organization's](#) external auditor, if any, **if the [member](#) determines such disclosure** 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.

**.34 Further action by the [member](#) may include reporting the noncompliance or suspected noncompliance to an appropriate authority unless prohibited by laws or regulations. In determining whether to disclose the matter to an appropriate authority, the [member](#) may consider the factors in paragraph .27.**

### **Documentation**

.35 In relation to an identified or suspected act of noncompliance that falls within the scope of this interpretation **section**, 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

***Effective Date***

.36 This interpretation is effective one year after announcement is published in the *Journal of Accountancy*.

**Text of new proposed definition “Financial Statement Attest Services”**

**Financial statement attest services.** Services in which a member performs a financial statement audit or review, or a compilation for which the member’s report does not disclose a lack of independence.



## Text of proposed revision to interpretation “Ethical Conflicts”

### 1.000 Introduction

#### 1.000.020 Ethical Conflicts

(Deletions are stricken and highlighted. Additions are bold italic and highlighted.)

- .01 An ethical conflict arises when a member encounters one or both of the following:
- a. Obstacles to following an appropriate course of action due to internal or external pressures
  - b. Conflicts in applying relevant professional standards or legal standards

~~For example, a member suspects a fraud may have occurred, but reporting the suspected fraud would violate the member’s responsibility to maintain client confidentiality.~~

- .02 Once an ethical conflict is encountered, a member may be required to take steps to best achieve compliance with the rules and law. In weighing alternative courses of action, the *member* should consider factors such as the following:

- a. Relevant facts and circumstances, including applicable rules, laws, or regulations
- b. Ethical issues involved
- c. Established internal procedures

- .03 The *member* should also be prepared to justify any departures that the *member* believes were appropriate in applying the relevant rules and law. If the *member* was unable to resolve the conflict in a way that permitted compliance with the applicable rules and law, the *member* may have to address the consequences of any violations.

- .04 Before pursuing a course of action, the *member* should consider consulting with appropriate persons within the firm or the organization that employs the *member*.

- .05 If a *member* decides not to consult with appropriate persons within the *firm* or the organization that employs the *member* and the conflict remains unresolved after pursuing the selected course of action, the *member* should consider either consulting with other individuals for help in reaching a resolution or obtaining advice from an appropriate professional body or legal counsel. The *member* also should consider documenting the substance of the issue, the parties with whom the issue was discussed, details of any discussions held, and any decisions made concerning the issue.

- .06 If the ethical conflict remains unresolved, the *member* will in all likelihood be in violation of one or more rules if he or she remains associated with the matter creating the conflict. Accordingly, the *member* should consider his or her continuing relationship with the engagement team, specific assignment, *client*, *firm*, or employer. [No prior reference: new content.]

**.07 Refer to the “Responding to Noncompliance With Laws and Regulations” interpretation [1.170.010] of the “Integrity and Objectivity Rule” [1.100.001]) for additional guidance.**