

## 1553—RESPONDING TO NONCOMPLIANCE WITH LAWS AND REGULATIONS IDENTIFIED IN THE COURSE OF CLIENT SERVICE ENGAGEMENTS OTHER THAN AUDITS OF FINANCIAL STATEMENTS

### Introduction

This Section of the Manual provides policies and guidance relating to situations where Partners, Professional Staff and others employed by a Member Firm encounter or are made aware of non-compliance with laws and regulations in the course of providing service to a Client, other than in the performance of an audit of financial statements. The policies and guidance have been developed based on the key provisions of the Responding to Non-Compliance with Laws and Regulations Pronouncement (“Pronouncement”) issued by the International Ethics Standards Board for Accountants (“IESBA”) and are designed to facilitate compliance with the standard. This Section applies regardless of the nature of the Client including whether or not it is a public interest entity.

In some jurisdictions, there are legal or regulatory provisions governing how professionals are required to address non-compliance or suspected non-compliance which may differ from or go beyond this Section. When encountering such non-compliance or suspected non-compliance, the professional has a responsibility to obtain an understanding of those provisions and to comply with them, including any requirements set forth in Member Firm policy related to reporting the matter to an appropriate authority and any prohibition on alerting the Client prior to making any disclosure, for example, pursuant to anti-money laundering legislation.

Each Member Firm Reputation & Risk Leader (RRL) should establish and implement policies and procedures that facilitate professionals applying the policies set out in this Section of the Manual consistent with the Member Firm’s local laws and regulations.

### Policies and Guidance

1. In some jurisdictions, there are legal or regulatory provisions governing how Professionals are required to address non-compliance or suspected non-compliance with laws and regulations which may differ from or go beyond this Section. **In such circumstances, the requirements included in relevant Member Firm policies regarding non-compliance with laws or regulations, such as Anti-Money Laundering policies should be followed in order to comply with local laws and regulations.**
2. A distinguishing mark of the audit and accountancy profession is its acceptance of the responsibility to act in the public interest. When responding to non-compliance or suspected non-compliance with laws and regulations, the objectives of the professional are:

- a) To comply with the fundamental principles of integrity and professional behavior;
  - b) By alerting management or, where appropriate, those charged with governance of the Client, to seek to:
    - i) Enable them to rectify, remediate or mitigate the consequences of the identified or suspected non-compliance; or
    - ii) Deter the commission of the non-compliance where it has not yet occurred; and
  - c) To take such further action as appropriate in the public interest.
3. Definition: For purposes of this Section, the “Professionals” are all Partners, Professional Staff and others employed by a Member Firm, and external experts, consultants and independent contractors engaged by a Member Firm providing service to a Client.
4. This Section sets out the approach to be taken when a Professional encounters or is made aware of non-compliance or suspected non-compliance with:
- a) Laws and regulations generally recognized to have a direct effect on the determination of more than clearly inconsequential amounts and disclosures in the Client's financial statements; and
  - b) Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the 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 more than clearly inconsequential penalties.
5. For purposes of this Section, non-compliance with laws and regulations (“Non-compliance”) comprises acts of omission or commission, intentional or unintentional, 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 which are contrary to the prevailing laws or regulations.
- Examples of laws and regulations which this Section addresses include those that deal with:
    - Fraud, corruption and bribery
    - Money laundering, terrorist financing and proceeds of crime
    - Securities markets and trading
    - Banking and other financial products and services

- Data protection
- Tax and pension liabilities and payments
- Environmental protection
- Public health and safety
- Other matters that may have wider public interest implications in terms of potentially substantial harm to investors, creditors, employees or the general public.

Non-compliance may result in fines, litigation or other consequences for the Client that may have a more than clearly inconsequential 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. Whether an act constitutes Non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body.

- Examples of matters to which this Section does not apply:
    - Matters that are clearly inconsequential, judged by their nature and their impact, financial or otherwise, on the Client, its stakeholders and the general public. **Member Firm policies with additional requirements regarding such matters should be followed.**
    - Personal misconduct unrelated to the business activities of the Client
    - Non-compliance other than by a Client or those charged with governance, management, or other individuals working for or under the direction of the Client
6. It is the responsibility of an entity's management, with the oversight of those charged with governance, to ensure that business activities are conducted in accordance with applicable laws and regulations. It is also the responsibility of management and those charged with governance to identify and address any Non-compliance.
  7. **Where a Professional becomes aware of a matter to which this Section applies, the steps that the Professional takes to comply with this Section should be taken on a timely basis, having regard to the Professional'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.**

8. In some jurisdictions, there are legal or regulatory provisions governing how Professionals are required to address Non-compliance or suspected Non-compliance which may differ from or go beyond this Section. When encountering such Non-compliance or suspected Non-compliance, the Professional has a responsibility to obtain an understanding of those provisions and comply with them, including any requirements set forth in Member Firm policy related to reporting the matter to an appropriate authority and any prohibition on alerting the Client prior to making any disclosure, for example, pursuant to anti-money laundering legislation.
9. **Professionals engaged in the performance of *audits of financial statements* should comply with the requirements set out in Section 3560 of the DTTL Policies Manual.**

***Responsibilities of Professionals Engaged to Perform Professional Services Other than Audits of Financial Statements***

10. **If a Professional, engaged in performing Client service other than an audit of financial statements, becomes aware of information concerning an instance of Non-compliance or suspected Non-compliance, the Professional should notify and consult with the Engagement Partner.**
11. **The Engagement Partner 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 be about to occur.** In obtaining that understanding, the Engagement Partner may involve other Professionals engaged in performing service at the Client where the act of Non-compliance is identified or suspected.
12. **The Engagement Partner should consider whether sufficient understanding of the matter, including the nature of the act and the circumstances in which it has occurred or may occur, has been obtained.** In obtaining an understanding of the matter, the Engagement Partner is expected to apply knowledge, professional judgment and expertise, but is not expected to have a level of knowledge of laws and regulations that is greater than that which is required to undertake the engagement.
13. **The Engagement Partner should initiate a consultation with the respective Member Firm RRL (or his or her designee) for all acts of Non-compliance, even when such acts are only suspected. The Member Firm RRL (or his or her designee) determines whether the matter meets the criteria of Non-compliance subject to the policies in this Section of the Manual and, if so, should guide the Engagement Partner on whether to and, if so, how to:**
  - **Communicate it to and address it with Client management and those charged with governance**

- **Communicate the matter to the Client's external auditor**
- **Consider whether further action is needed**
- **Document the matter**

The Member Firm RRL (or his or her designee) is encouraged to consider consulting with the Member Firm General Counsel or if none, DTTL General Counsel (Legal Counsel) to assist in determining the appropriate actions to take.

14. **If the Engagement Partner or the Member Firm RRL (or his or her designee) determine that the matter meets the criteria of "money laundering," as defined by local anti-money laundering laws or regulations, the Engagement Partner and the Member Firm RRL (or his or her designee) should address the matter by following local anti-money laundering laws and regulations and the applicable Member Firm policies and procedures.** In such circumstances, the policies in this Section of the Manual would ordinarily not be applicable.
15. **To clarify the Engagement Partner's understanding of the facts and circumstances relevant to the matter and its potential consequences, the Engagement Partner should discuss the identified or suspected Non-compliance with the appropriate level of Client management and, where appropriate, those charged with governance. However, before communicating the matter to Client management or those charged with governance, the Engagement Partner should first consider whether Client management or those charged with governance are already aware and if not should consult with the Member Firm RRL (or his or her designee) to determine whether such communication is appropriate under the circumstances and, if so, who the Engagement Partner should communicate with about the matter.**
16. The appropriate level of Client management with whom to discuss the matter is a question of professional judgment. This would ordinarily be at least one level above where the act of Non-compliance is identified or suspected. Other relevant factors to consider include:
  - The nature and circumstances of the matter.
  - The individuals actually or potentially involved.
  - The likelihood of collusion.
  - The potential consequences of the matter.
  - Whether that level of management is able to investigate the matter and take appropriate action.

- 17. The Engagement Partner, in conjunction with the Member Firm RRL (or his or her designee), should communicate the matter to the Lead Client Service Partner (LCSP) within the Member Firm and where appropriate to the Global LCSP, unless prohibited from doing so by law or regulation. If law or regulation prohibits the Global LCSP from being notified about the identified or suspected act of Non-compliance, the Member Firm RRL (or his or her designee) should consult with Legal Counsel and consideration should be given to consultation with DTTL General Counsel.**

***Communicate the Matter to the Client's External Auditor***

- 18. If the non-audit Engagement is being performed for an Audit Client of the same Member Firm, or a component of an Audit Client of the same Member Firm, the Engagement Partner should first communicate the Non-compliance or suspected Non-compliance to the respective Member Firm RRL (or his or her designee) and, under the direction of the Member Firm RRL (or his or her designee), to the Audit Engagement Partner within the Member Firm, unless prohibited from doing so by law or regulation. If law or regulation prohibits the Audit Engagement Partner from being notified about the identified or suspected act of Non-compliance, the Member Firm RRL (or his or her designee) should consult with Legal Counsel and consideration should be given to consultation with DTTL General Counsel.**
- 19. If the Engagement Partner is performing a non-audit service for an Audit Client of a different Member Firm or a component of an Audit Client of a different Member Firm, the Engagement Partner working with his or her Member Firm RRL (or his or her designee) should determine with whom to communicate the matter so the Audit Engagement Partner at whose Audit Client the act of Non-compliance was identified or suspected is made aware, unless prohibited from doing so by law or regulation. If law or regulation prohibits this communication, the Member Firm RRL (or his or her designee) should consult with Legal Counsel and consideration should be given to consultation with DTTL General Counsel.**
- For example, if the non-audit Engagement is being performed at Member Firm A for an Audit Client of Member Firm B, the non-audit Engagement Partner and Member Firm A's RRL (or his or her designee) should, unless prohibited from doing so by law or regulation, determine with whom to communicate the matter so the Audit Client Engagement Partner at Member Firm B is made aware. If law or regulation prohibits this communication, Member Firm A's RRL (or his or her designee) should consult with his or her Member Firm's General Counsel and consideration should be given to consultation with DTTL General Counsel.

20. **If the Engagement Partner is performing a non-audit service for a Client that is not an Audit Client or component of an Audit Client of a Member Firm, the consideration of whether to communicate the Non-compliance or suspected Non-compliance to the firm that is the Client's external auditor, if any, is part of the required consultation with the Member Firm RRL (or his or her designee), and is subject to local laws and regulations. Prior to any communication to the Client's non-Member Firm external auditor, the RRL should consult with Legal Counsel.**

21. Factors relevant to considering the communication in accordance with paragraphs 17 through 19 include:

- Whether doing so would be contrary to law or regulation
- Whether there are restrictions about disclosure imposed by a regulatory agency or prosecutor in an ongoing investigation into the Non-compliance or suspected Non-compliance
- Whether the purpose of the engagement is to investigate potential Non-compliance within the entity to enable it to take appropriate action
- Whether the Client's management or those charged with governance have already informed the Client's external auditor about the matter
- The likely materiality of the matter to the audit of the Client's financial statements or, where the matter relates to a component of a group, its likely materiality to the audit of the group financial statements

22. In all cases, the communication, if not prohibited by law or regulation, is to enable the auditor to be informed about the Non-compliance or suspected Non-compliance.

***Consider Whether Further Action is Needed***

23. **As part of the consultation with the Member Firm RRL (or his or her designee), the Engagement Partner should consider whether further action is needed in the public interest.** Whether further action is needed and the nature and extent of it, will depend on the factors such as:

- The legal and regulatory framework
- The appropriateness and timeliness of the response of Client management and, where applicable, those charged with governance
- The urgency of the matter

- The involvement of Client management and those charged with governance
  - The likelihood of substantial harm to the interest of the Client, investors, creditors, employees, and the general public
24. If deemed appropriate by the Member Firm RRL (or his or her designee), further action by the Engagement Partner may include disclosing the matter to an appropriate authority even when there is no legal or regulatory requirement to do so and/or withdrawing from the engagement and the professional relationship, where permitted by law or regulation.
25. In considering whether to disclose the matter to an appropriate authority, the Engagement Partner, as part of the consultation with the Member Firm RRL (or his or her designee), would ordinarily evaluate the following relevant factors:
- Whether doing so would be contrary to law or regulation
  - Whether there are restrictions about disclosure imposed by a regulatory agency or prosecutor in an ongoing investigation into the Non-compliance or suspected Non-compliance
  - Whether the purpose of the engagement is to investigate potential Non-compliance within the entity to enable it to take appropriate action
26. **If, as a result of consultation with the Member Firm RRL (or his or her designee), the Engagement Partner determines that disclosure of the Non-compliance or suspected Non-compliance to an appropriate authority is an appropriate course of action in the circumstances, the Engagement Partner and RRL (or his or her designee) should consult Legal Counsel. To the extent that the matter may involve more than one Member Firm, the matter should be discussed with DTTL General Counsel prior to disclosing the matter to an appropriate authority.** This disclosure to an appropriate authority will not be considered a breach of duty of confidentiality under applicable ethical codes where such codes are compliant with the IESBA Code of Ethics for Professional Accountants or Section 1630 of the DTTL Policies Manual, unless prohibited by law or regulation. As part of the consultation with the Member Firm RRL, the Engagement Partner would ordinarily identify and discuss whether there are confidentiality provisions within the engagement letter that require consideration in making this determination.
27. When making such disclosure to authorities, **the Engagement Partner should act in good faith and exercise caution when making statements and assertions. With the assistance of the Member Firm RRL (or his or her designee), the Engagement Partner should also consider whether it is appropriate to inform**



**the Client of the Engagement Partner's intentions before disclosing the matter where not prohibited by law or regulation.**

28. In exceptional circumstances, the Engagement Partner may become aware of actual or intended conduct that he or she has reason to believe would constitute an imminent breach of a law or regulation that would cause substantial harm to the Non-Audit Client's investors, creditors, employees, or the general public. **In such circumstances, the Engagement Partner should notify the Member Firm RRL (or his or her designee) who will determine if consultation with Legal Counsel is necessary. Having considered whether it would be appropriate to discuss the matter with Client management or those charged with governance of the Client, the Member Firm RRL (or his or her designee) may conclude that immediate disclosure of the matter to an appropriate authority is appropriate in order to prevent or mitigate the consequences of such imminent breach of law or regulation. Prior to any such disclosure the Member Firm RRL (or his or her designee) should consult with Legal Counsel to determine the approach for the disclosure.** This would ordinarily not be considered a breach of duty of confidentiality under applicable ethical codes where such codes are compliant with the IESBA Code of Ethics for Professional Accountants or Section 1630 of the DTTL Policies Manual. Consideration of engagement letter terms would be discussed as part of the consultations.

#### ***Document the Matter***

29. In relation to an identified or suspected act of non-compliance that falls within the scope of this Section, the Engagement Partner is encouraged to document:
- The matter
  - The results of discussion with Client management and, where applicable, those charged with governance and other parties
  - How Client management and, where applicable, those charged with governance have responded to the matter
  - The courses of action the Engagement Partner considered, the judgments made and the decisions that were taken
  - How the Engagement Partner is satisfied that the he/she has fulfilled the responsibilities set out in this Section

#### ***Member Firm Processes***

30. **Each Member Firm RRL should establish and implement policies and procedures that facilitate professionals applying the policies set out in this**

**Section of the Manual consistent with the Member Firm's local laws and regulations.**

<b>Effective Date</b>
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**Issued July 12, 2017 and effective July 15, 2017. All personnel of Member Firms who encounter or are made aware of non-compliance or suspected non-compliance following the issuance date and before July 15, 2017 are required to discuss the matter with the Member Firm RRL (or his or her designee) to determine whether any additional action is required.**