

CHAPTER 3

# ICAI Code of Ethics – Responding to NOCLAR

**This article aims to:**

Discuss the key requirements pertaining to Non-Compliance with Laws and Regulations (NOCLAR) which are enunciated in the Institute of Chartered Accountants of India (ICAI) Code of Ethics on professional accountants in service and public practice.

## Introduction

The Code of Ethics (the Code) issued by ICAI lays down the professional obligations and ethical responsibilities of the members whether in practice or in service. The 12 edition of the Code of Ethics (Code of Ethics, 2019) introduced requirements relating to NOCLAR for both members in service as well as in practice (professional accountants), coming into effect from 1 July 2020. However, the applicability was deferred due to COVID-19 pandemic.

Recently, ICAI, vide an announcement dated 29 September 2022 made the NOCLAR requirements applicable with effect from 1 October 2022. In this article, we aim to discuss the impact of NOCLAR provisions on both members in service as well as in practice and the related key takeaways.

## What is NOCLAR?

A professional accountant<sup>1</sup> may encounter an instance of NOCLAR or suspected NOCLAR, while rendering professional services to a client, or carrying out professional activities for an employer. Section 260 and 360, contained in Volume I of the Code provides detailed guidance in assessing the implications of NOCLAR instances encountered and the possible courses of action for addressing the same.

1. A professional accountant refers to an individual who is a member of the ICAI



## Objectives of NOCLAR

Professional accountants have a responsibility to act in the public interest. They should comply with principles of integrity and professional behaviour. They should alert management/Those Charged With Governance (TCWG) on situations of identified/suspected non-compliance.

NOCLAR in case of employment with listed entities (Section 260)	NOCLAR during the course of audit engagements of listed entities (Section 360)
<p><b>Applicability:</b> The section guides the <b>senior professional accountants in service</b> (senior professional accountants), who are in employment of the listed entities. Senior professional accountants are the directors, officers or senior employees who are able to exert significant influence over, and make decisions regarding the acquisition, deployment and control of the employing organisation's human, financial, technological, physical and intangible resources. Senior professional accountants refer to the KMP of the entity.</p> <p>The section helps assess the implications of the matter and the possible courses of action when responding to non-compliance or suspected non-compliance with:</p> <ol style="list-style-type: none"> <li>Laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the employing organisation's financial statements and</li> <li>Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the employing organisation's financial statements, but compliance with which might be fundamental to the operating aspects of the employing organisation's business, to its ability to continue its business, or to avoid material penalties. These include compliances with the terms of an operating license, compliance with regulatory solvency requirements, or compliance with environmental regulations etc.</li> </ol> <p>These requirements do not address:</p> <ul style="list-style-type: none"> <li>Personal misconduct unrelated to the business activities of the employing organisation, and</li> <li>Non-compliance by parties, other than those specified in the definition below</li> </ul> <p><b>Definition:</b> The Code defines that NOCLAR comprises acts of omission or commission, intentional or unintentional, which are contrary to the prevailing laws or regulations committed by the following parties:</p> <ul style="list-style-type: none"> <li>The professional accountant's employing organisation</li> <li>TCWG of the employing organisation</li> <li>Management of the employing organisation, or</li> <li>Other individuals working for or under the direction of the employing organisation.</li> </ul>	<p><b>Applicability:</b> The reporting under this section is required by a professional accountant in practice during the course of audit engagements<sup>2</sup> of entities, the shares of which are listed on recognised stock exchange(s) in India and have a <b>net worth of INR250 crore or more</b>. This section guides the professional accountant in assessing the implications of the matter and the possible courses of action when responding to non-compliance or suspected non-compliance with:</p> <ol style="list-style-type: none"> <li>Laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the client's financial statements, and</li> <li>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 might be fundamental to the operating aspects of the client's business, to its ability to continue its business, or to avoid material penalties. These include compliances with the terms of an operating license, regulatory solvency requirements, or environmental regulations, etc.</li> </ol> <p>These requirements do not address:</p> <ul style="list-style-type: none"> <li>Personal misconduct unrelated to the business activities of the client, and</li> <li>Non-compliance by parties, other than those specified in the definition below.</li> </ul> <p><b>Definition:</b> The Code defines that NOCLAR comprises acts of omission or commission, intentional or unintentional, which are contrary to the prevailing laws or regulations committed by the following parties:</p> <ul style="list-style-type: none"> <li>A client</li> <li>TCWG of a client</li> <li>Management of a client, or</li> <li>Other individuals working for or under the direction of a client.</li> </ul>

2. For Section 360 an 'audit' or 'audit engagement' shall mean a reasonable assurance engagement in which a professional accountant in public practice expresses an opinion whether financial statements give a true and fair view in accordance with an applicable financial reporting framework.

## Responsibility of the senior professional accountants in service relating to NOCLAR

- The Code lays down steps that a senior professional accountant should follow while assessing the nature of the matter and the potential harm to the interests of the employing organisation, investors, creditors, employees or general public. It highlights that a professional accountant would need to apply knowledge, expertise and professional judgement to determine the need for, and nature and extent of further action. It might require seeking advice and determining whether to disclose the matter to an appropriate authority.
- If, during the course of carrying out professional activities, a senior professional accountant becomes aware of any information relating to NOCLAR or suspected NOCLAR, he/she should obtain an understanding of the relevant matter and thus determine:
  - a. The nature of the matter encountered and the circumstances in which it has occurred or might occur,
  - b. The application of the relevant laws and regulations to the circumstances, and
  - c. An assessment of the potential consequences to the organisation, investors, creditors, employees or the wider public.
- Depending on the nature and significance of the matter, a senior professional accountant might take appropriate steps to investigate the matter internally. He/she might also consult confidentially with others within the employing organisation, ICAI, or a legal counsel.
- A senior professional accountant should discuss the matter with his/her immediate superior(s). If the immediate superior(s) appear to be involved in the matter, the matter should be discussed with the next higher level of authority within the employing organisation.
- Basis the response of the senior professional accountant's superiors and TCWG, the accountant should determine if further action is needed in the public interest.
- Additionally, it must also be determined if there is a need to disclose the matter to the employing organisation's external auditor.
- Further action that the senior professional accountant might take includes:
  - a. Informing the management of the parent entity of the matter, if the employing organisation is a member of a group,
  - b. Disclosing the matter to an appropriate authority as specified under respective law, or
  - c. Resigning<sup>3</sup> from the employing organisation.

## Responsibility of the employing organisation's management and TCWG

It is the responsibility of the management or TCWG of the employing organisation to identify and address any instances of NOCLAR and also ensure that the business activities are conducted in accordance with the appropriate laws and regulations.

## Responsibility of the professional accountants in public practice relating to NOCLAR

- If a professional accountant engaged to perform an audit of financial statements becomes aware of any information relating to NOCLAR or suspected NOCLAR, he/she should obtain an understanding of the relevant matter and thus determine the nature of the matter encountered and the circumstances in which it has occurred or might occur.
- Depending on the nature and significance of the matter, the professional accountant might consult confidentially with others within the firm, a network firm, ICAI, or a legal counsel.
- The matter so identified should be discussed with the appropriate level of management and, where appropriate, TCWG. The purpose of the discussion is to clarify the professional accountant's understanding of the facts and circumstances relevant to the matter and its potential consequences. The discussion

might also prompt management or TCWG to investigate the matter.

- The professional accountant should discuss the non-compliance or suspected non-compliance with management/TCWG to take appropriate and timely actions. Basis the communication the management/TCWG should communicate the matter to appropriate authorities.
- In case of audit of consolidated financial statements, the professional accountant should communicate the matter to the group engagement partner and the group partner should consider whether the matter would be relevant to one or more components and communicate to components engagement teams.
- Additionally, it should be determined if there is a need to discuss the matter with the internal auditors, where applicable.
- Further action that a professional accountant might take includes:
  - a. Disclosing the matter to an appropriate authority as specified under respective law, or
  - b. Withdrawing<sup>4</sup> from the engagement and the professional relationship where permitted by law or regulation.

3. Resigning is not a substitute for taking other actions that might be needed to achieve the senior professional accountant's objectives under Section 260. However, there might be limitations as to the further actions available. In such circumstances, resignation might be the only available course of action.

4. Withdrawing from the engagement and the professional relationship is not a substitute for taking other actions that might be needed to achieve the professional accountant's objectives under Section 360. However, there might be limitations as to the further actions available. In such circumstances, withdrawal might be the only available course of action.

## Responsibility of the management and TCWG of the client

It is the responsibility of the management or TCWG of the client to identify and address any instances of NOCLAR and also ensure that the business activities are conducted in accordance with the appropriate laws and regulations.

**Examples:** Some of the examples of laws and regulations addressed by Section 260 and 360 of the Code 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.

## Key considerations

- Currently, the provisions of Section 360 of the Code are applicable to only such listed entities that have a net worth of INR250 crore or more. However, it has been specified that the applicability would be subsequently extended to all listed entities. Thus, the management and the practitioners auditing listed entities having net worth of less than INR250 crore should start preparing the required system and necessary procedures for appropriate identification and disclosure of instances of NOCLAR.
- The requirements have placed a greater expectation on the senior professional accountants to take appropriate action for responding to NOCLAR instances. This is largely on account of their roles, positions and spheres of influence within the employing organisation. Accordingly, senior professional accountants should take note of the NOCLAR provisions to effectively discharge their responsibilities in this regard.
- Audit Committee(s) of companies should note NOCLAR requirements. Many organisations have established protocols and procedures for raising non-compliance or suspected non-compliance internally. These protocols and procedures include, for instance, an ethics policy or internal whistle-blowing mechanism. Thus, organisations would need to assess whether such frameworks meet the requirements of NOCLAR as per the Code. They may also develop training programmes for the employees for identifying, reporting and minimising NOCLAR instances.
- Presently, SA 250, *Consideration of laws and regulations in an audit of financial statements* and relevant clauses under the Companies (Auditor's Report) Order, 2020 (CARO 2020) provide guidance to the auditors for identifying and reporting violations relating to non-compliance or suspected non-compliance. Additionally, Section 143 of the Companies Act, 2013 provides that if the auditor of a company,

has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of INR1 crore or more, has been committed against the company by its officers or employees, he/she must report the matter to the Central Government. Section 177 of the Companies Act, 2013 states the requirement for every listed company, or such classes of companies, as may be prescribed to establish a vigil mechanism for directors and employees to report any concerns, if encountered during the course of performing their duties. Thus, NOCLAR provisions are another tool to report such violations and minimise such threats.

NOCLAR is a complex subject matter and would require analysis and judgement. The professional accountants may obtain legal advice or consult on a confidential basis with the ICAI.

