

Indian Stakeholders are Well-Aligned with Our Emerging Priorities, Says IESBA Chairman



Having earned his education from Yale and Sloan School of Management, and taught at various universities, the emeritus professor of Financial Economics at the University of Athens, Dr. Stavros B. Thomadakis, has been reappointed Chair of International Ethics Standards Board for Accountants (IESBA) for a one-year renewable term, after he completed his first three-year-term as its Chair in December 2017. IESBA is an independent standard-setting body, which serves the public interest by setting robust and internationally appropriate ethics standards for the professional accountants globally and seeks to raise the bar of their ethical conduct and practice. Previously, Dr. Thomadakis has served as first Chair of the Public Interest Oversight Board (PIOB) for the years 2005-2011, which oversees the activities of IESBA and other standard setters. His research interests lie in the issues concerning regulation, standard-setting, governance, valuation and financial crises. In November 2018, Dr. Thomadakis visited ICAI along with IESBA Technical Director Mr. Ken Siong and expressed his wish to speak to the ICAI through its Journal, The Chartered Accountant. Then, a team from ICAI, comprising the offices of Editorial Board and Ethical Standards Board, had an interview session with the IESBA team, seeking and absorbing their responses thoroughly in order to communicate the same to the stakeholders of the profession. Read the interview to understand the perspectives of IESBA and its action plan in the best interests of best ethical practices for auditors and professional accountants globally...

Interview

ICAI¹: In appreciation of your contribution and dedicated efforts for the cause of ethics in global accountancy profession, you have been reappointed Chair of the IESBA. In the past, you have also headed the Public Interest Oversight Board. With that kind of professional experience, your visit is an important event for the Indian accountancy profession. Apart from what you have already achieved as IESBA Chair in your previous term, do you have any new agenda to follow and achieve?

IESBA Chairman²: Yes, thank you. That is a good question to start with. First, let me say that it is very important for IESBA and me, personally, to be in India and to be in touch with the ICAI. So, our present contact will enable communication and mutual understanding. It has been a privilege to contact via webcam with a large number of your membership.

Now, to your question. A major challenge that we have before us in the new year is the strategy of the Board. We expect to finalise a Restructured *Code* by the end of 2017 with many enhancements that will be launched very soon. Therefore, priority now focuses on our strategy and work plan (SWP) for the period 2019-23. Formulating the SWP is an exercise involving worldwide consultation. We have conducted a global survey of stakeholders in which, by the way, we have a good number of responses from India along with many other jurisdictions. We are pleased with the quality of the Indian and overall response.

Our next step is a consultation paper based on survey results and our own views on priorities. We need to draw the views of stakeholders, be they professional accountants, regulators, policy makers, users of financial statements or investors. Our strategy plan seeks to set priorities with world relevance and high significance for the public interest. Furthermore, we want to be responsive to rapid change and new challenges to the accounting profession.

Some priorities are already emerging: Technological innovations and their significance for the Code is one. Ethical implications of data analytics, artificial intelligence, blockchain and related changes to the way practice and judgement are exercised should be looked at. Technology affects the mode of delivery of services which is a related

topic. The mode of delivery of services may have an impact on auditor independence, for example, in our understanding of the concept of an engagement team. In addition, confidentiality may be affected, touching on issues of data security. So, the challenges of technological innovation can be pervasive.

Another priority is the issue of aggressive tax planning. In a world with different tax regimes and tax competition, where accountants play advisory roles in tax planning, issues of ethics are very pertinent to the public interest.

A re-examination of the concept of materiality is another priority. Materiality is a central concept for the Code. It is frequently misunderstood and possibly abused. One example is materiality with respect to the provision of non-audit services to an audit client. Materiality thresholds on the permissibility of such services must gain higher clarity.

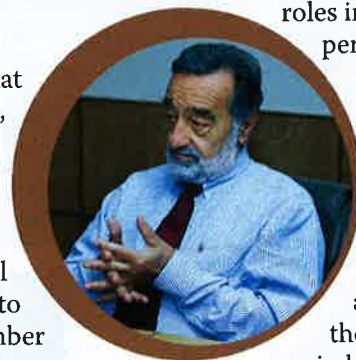
Another priority topic we are considering is bringing greater clarity to the definitions of a listed entity and a "public interest entity" (PIE), given developments in capital markets and PIE regulation around the world.

When pursuing these priorities we consider the global role of the profession, but also the large segment represented by small and medium practices (SMPs) within it, as here in India. The IESBA Code applies to all firms, large or small. This will remain a solid consideration as we formulate our strategy.

ICAI: Right. We are sure that your concerns for SMPs will serve the interests of our profession in the times to come. We will appreciate if you could define *ethics* and *culture of ethics* for our readers, since you have talked about their inculcation in organisations. Also, how can we do that?

IESBA Chairman: Ethics is a very important aspect of accountants' practice, as it articulates fundamental principles to be applied. Ethical standards are about behaviour and this is often dependent on culture and legal institutions.

There are legal and cultural differences across the globe. That is why our strategic orientation is for a principle-based and not rule-based Code. A rule-based Code cannot respond to legal and cultural specificities. A principle-based Code lays



¹ Editorial Board and Ethical Standards Board of ICAI [The Institute of Chartered Accountants of India].

² Dr Stavros Thomadakis [Chairman of International Ethics Standards Board for Accountants (IESBA) since 1st January 2015].

claim to fundamental values and principles. The five fundamental principles in the Code are valid across cultures. It is fitting for a globalised profession to base its practice on compliance with fundamental principles.

Indeed, national bodies, regulators, and others frequently ask for rules in the Code. This is not our path. The Code must remain principle-based. National jurisdictions, like the Institute here or the Government or the regulators, can always add on more stringent provisions to the Code, if they feel these are appropriate in the national context; the Code should remain principle-based, if it is going to be global.

ICAI: Basically, you are going back to more basics.

IESBA Chairman: Well, yes, the fundamentals. The Code provides application material that enables the implementation of the principles.

ICAI: With the presence of ethics and culture of ethics in the organisations, obviously our coming generations will have happier societies and a safer earth to exist. Do you recommend a culture of ethics in families too, since you have discussed principle-based ethics?

IESBA Chairman: Yes, it is worth remembering precisely that. Of course, ethics— a Greek word – is extremely important for families, societies and economic actors. It is extremely important for education and equally for politics, another Greek word, by the way.

India and Greece share ancient civilisations and notions of Ethics. I believe that a more ethical world is a better and more just world, but does not come automatically. We must work to maintain ethical standards because we are human, and humans always can slip to unethical practices. Switching back to my role as Chairman of IESBA, the Code should be an example for other professions and organisations. The accounting profession is globally organised in a unique way. One of the linchpins of its global organisation is the Code of Ethics. Therefore the profession everywhere, in India, Greece, or America, should practice ethics strongly, and push others to emulate that example.

ICAI: Thank you, Dr. Thomadakis! You have referred to limited resources before and, therefore, a need for priorities. Can the IESBA think of setting up nodal entities across the globe, which they could use to communicate their message locally and on a more direct basis? Will this serve the purpose of the Board?

IESBA Chairman: That is an important question and has two aspects. We are a standard-setting board, and we have to engage the potential users of the standards in order to optimise the applicability of our standard-setting. The other aspect is implementation. I would like to turn to our Technical Director to elaborate on these two aspects of our work.

IESBA TD³: Indeed, the Board's remit is standard setting, but not in isolation. The IESBA engages with a wide range of stakeholders, including the IESBA Consultative Advisory Group, national standard setters (NSS), the global and national regulatory community, the Forum of Firms (which comprises the 27 largest international networks of firms), and the SMP and Professional Accountants in Business (PAIB) committees. The input the Board receives from its diverse constituencies enables it to calibrate its standards for balance and global applicability. At the same time, our discussions with these constituencies often address matters of implementation. Besides devoting some resources to commissioning implementation support materials, the Board leverages its regular meetings with NSS, firms, IFAC member bodies, and the IFAC SMP and PAIB Committees to explain and convey important messages about recent and upcoming changes to the Code, thereby facilitating implementation.



ICAI: Thank you both for your significant insight! Dr. Thomadakis, since you have mentioned NOCLAR⁴, we have a question there. Recently, IESBA approved new ethics standards corresponding to non-compliance with laws and regulations, effective from July 2017. Would you like to explain the significance of those standards for our readers?

³ Mr. Ken Siang [IESBA Technical Director], who accompanied Dr. Thomadakis for the interview.

⁴ *Responding to Non-compliance with Laws and Regulations (NOCLAR)*, is an international ethics standard issued by IESBA, to provide a unique framework to auditors and other professional accountants, which guides them in acting in public interest, if they come across a potential illegal act, i.e. NOCLAR, of a client/an employer.

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IESBA Chairman: First of all, NOCLAR is path-breaking, touching all professional accountants. This standard seeks to consolidate public trust in the accounting profession. It is a principle-based standard, describing the decision-making process of professional accountants, who are required not to turn a blind eye when they become aware of serious non-compliance. Globally, NOCLAR has generated a lot of buzz among professional accountants, regulators, governments, policymakers, and educators. I would like our Technical Director to add more perspectives here, since he is a great specialist in NOCLAR.

IESBA TD: Indeed, it is a privilege for us to come to India and to speak about NOCLAR. As Dr. Thomadakis said, IESBA believes that this standard will make a significant contribution to the public interest. Over its six years of development, NOCLAR underwent extensive rounds of discussions with stakeholders globally. It establishes a framework that enables the auditor or accountant to think about how best to navigate a NOCLAR situation that sometimes will be uncertain or complex, and come to the right decision eventually. It is a proportionate and balanced standard in the sense that it recognises the important roles and responsibilities of management and those charged with governance (TCWG) of the organisation in addressing NOCLAR. It also recognises the different roles and responsibilities of different categories of accountants – auditors vs. accountants in public practice, and accountants in business who have senior-level authority versus those who are at a more junior level – and balances their responsibilities accordingly. It is also holistic since it covers the broad range of laws and regulations relevant to accountants' work in their chosen fields.

It is important to understand that the standard doesn't require auditors or accountants to disclose NOCLAR to an appropriate authority; rather, it specifies relevant considerations and courses of action to enable them to assess how best to respond in public interest. It specifies a response process that includes an escalation mechanism for the auditors or accountants to raise the issue with management or TCWG, to assess their response and encourage them to take actions to address the issue, and eventually to make a judgement as to whether further action is necessary in the public interest. In many instances, NOCLAR will be addressed since management or TCWG will often appreciate the

risks and legal exposures in not addressing the issue themselves. In a few cases, however, management will unethically continue to perpetrate the act or not address its consequences. This is when the Standard will require the auditors or accountants to assess whether something more should be done.

One course of action is to disclose the matter to the authority. Another could be to resign from the engagement, to send a strong message to management that the auditor is not willing to associate with the NOCLAR. If the auditor chose to resign, the Standard requires the predecessor auditor to communicate information about the NOCLAR to the proposed auditor, thereby enabling the latter to consider the issue in deciding whether to accept the engagement. So, there is a carefully laid-out thought process to enable the auditor to arrive at the right decisions in the process.

What the Standard seeks to achieve is to ensure that the auditor or accountant does not turn a blind eye to the issue. Second, it is to ensure that management or TCWG act appropriately to address the matter. And thirdly, if the issue is still not appropriately resolved, it stimulates auditors or accountants to consider whether they need to take any action themselves in the public interest.

While this standard has achieved global acceptance, IESBA looks forward to hearing about implementation experiences around the world, including in India as ICAI considers adopting this Standard.

ICAI: Since you have advocated for principle-based standards, expectations, in a way, are going to be absolute. Since you have referred to the compliance issues *vis-à-vis* Indian Chartered Accountants, and that is our next question, do you perceive any expectation gap in the Indian Chartered Accountants who are working abroad *vis-à-vis* the culture of ethics?

IESBA Chairman: No, I do not.

ICAI: Do you have a message for them?

IESBA Chairman: We certainly have a message. With respect to NOCLAR, we want professional accountants not to rely on hearsay, but to read and understand the standards first-hand, before they decide to implement them.

I understand that in India, there are many specific laws that are rule-based and seek to strengthen

ethical behaviours. In our opinion, the Code of Ethics should function as a safety net for ethical behaviour, as the local laws may not be holistic. So, the adoption of the Code will create a comprehensive foundation, which in some cases will have to adjust to specific laws and rules in a country. There is also an issue of appearance: India is now a world player. Therefore, it is important that ICAI – representing the second most populous national profession in the world – implement the global Code. This is good for India but also an excellent example for others to follow. This is my message.

ICAI: It is understood that IESBA is undertaking a future strategy plan for 2019-23. We had circulated the IESBA's online survey among our members as well as past Presidents to invite their opinions. ICAI as a regulator has also submitted its opinions. What would you say consensually the most important issue emerging for the future deliberation?

IESBA Chairman: First of all, thank you very much for disseminating our survey to all your members. I already explained our priorities, following Survey responses including technological innovation. Indian responses have been much in line with the world opinion. We understand this, as India is also undergoing rapid technological change, with ICAI being an important agent in understanding technological impacts. So naturally, Indian stakeholders are well aligned with our emerging priorities.

ICAI: Recently, rotation of audit firm is one of the significant changes that has been effected in India, with respect to companies. Our Council has also discussed it. Companies Act, 2013 of India is on the issue of rotation of auditors only. On the issue of rotation of partners in audit firms, it says that it is up to the company whether to rotate the partners. IESBA Code, on the other hand, has elaborate provisions for the partner rotation. From the global perspective, how do you think both will be effective as safeguards against the threats resulting from long association?

IESBA Chairman: My opinion is that partner rotation is a clear-cut safeguard for independence against the familiarity threat. Firm rotation may have other effects such as on competition. The *Code* does not include firm rotation and one of the reasons

it doesn't is because the Board felt it should not overstep into the competition area. Firm rotation is very complex. Some major jurisdictions have mandated it; others, the US for example, have not.

ICAI: We leave it up to the entity.

IESBA Chairman: What I would say that the entity should follow the *Code* recognising however that, sometimes, there may be situations where the two rotations may not work together, and local rules must be obeyed if they are stricter.

IESBA TD: The IESBA Code works in a complementary manner with applicable laws and regulations. So, let us take the situation in India, for example. Setting aside mandatory firm rotation, let us suppose that an engagement partner has been on the audit for many years and the entity signals its intent to have a different audit partner after 8 years. Our Code will kick in because the firm must apply the stricter of the Code or the national requirement. In this situation, because the time-on limit in the Code is 7 years, no matter what the entity wishes to do, the Code will require the firm to rotate the partner off after 7 years. Let us take the reverse situation. If the company decides after five years that it would like a different audit partner, this is perfectly okay because the application of the law has led to a stricter outcome. So, the Code works in a complementary manner with law or regulation.

ICAI: A large number of professional accountants are not in practice nowadays. Do you think there should be some different compliance with regard to them as compared to the professional accountants and auditors in practice, since they are also bound with the entity's obligations?

IESBA TD: There should not be any different level of expectation between accountants in public practice versus those in business. The fundamental ethical principles that apply to the former also apply to the latter. Admittedly, the nature of professional activities are different. However, the same conceptual framework, i.e. the foundation of the Code, applies to both those in public practice and those in business. So, those in business are also obliged to consider the particular facts and circumstances in their line of duty, and identify and address any threat to compliance with those fundamental principles. For

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example, threats that are created by circumstances related to financial interests or conflicts of interest, or by pressure within the organisation to act unethically, must be addressed as dictated by the conceptual framework. While the response may differ due to the nature of the professional service or professional activity, the ultimate obligation is the same, i.e. to comply with the fundamental principles.

ICAI: Sir, restructuring of the IESBA Code is an important project which is going on presently. How will the restructured Code be more useful in terms of compliance and stakeholder perception?

IESBA Chairman: Excellent question. The main virtue of the restructured Code is clarity, less scope for misunderstanding, doubt, misinterpretation or mistranslation. So, clearly, our expectation from the Restructured Code is easier adoption, application and compliance. This is proved by the fact that already many jurisdictions are preparing actively to adopt the Restructured Code without amendments. Of course, in India, where English, is broadly used, translation cannot be an issue, but still you may translate it into Hindi, Gujarati, Marathi or others. Our perspective is that the restructured Code will make life easier for those who adopt and use it. It will also raise investors' confidence in the standards and professional accountants. Hence, this will change the landscape including for small and medium enterprises.

IESBA TD: Equally, enforcement goes hand-in-hand with observance, and by observance, we mean compliance; so yes, the restructured Code will facilitate compliance. But it will also facilitate enforcement through greater clarity regarding the requirements that apply to firms, network firms and individual professional accountants. The restructured Code will basically enable the profession to earn greater trust from regulators and oversight bodies as well as the public.

ICAI: Professional ethics has now developed into a specialised stream with detailed provisions and procedures prescribed therein. India is a founder member of SAFA (South Asian Federation of Accountants) and one of the issues that was raised



recently in SAFA was how we would ensure that ethical requirements are complied with. On their recent visit to India, the CPA Afghanistan were curious too, how to ensure compliance with the provisions of ethics. So, how do you look into the mechanism that different jurisdictions adopt to ensure compliance with the professional ethics?

IESBA Chairman: We as standard-setters are not compliance-detectives. I pointed out to SAFA, and I would like to repeat, that as the restructured Code is considered in the region, SAFA undertake to monitor and facilitate adoption. Larger jurisdictions of SAFA should take the lead in this. Regional cooperation in implementation of the new Code is very important.



IESBA TD: Compliance indeed is a major role and function of professional accountancy organisations in different jurisdictions. So, IFAC member bodies like ICAI here do play an important role in establishing the oversight and disciplinary systems *vis-à-vis* their members. In the audit context, the role of audit oversight bodies is also important. They will have specific responsibilities to conduct inspections of audit engagements, and thereby enforce compliance with independence and ethical standards as well as auditing standards. Let me emphasise that our Board believes that a principle-based Code is as enforceable as a rule-based one, just as principle-based legislation is enforceable. At the same time, firms themselves have responsibilities under ISQC 1, the IAASB's standard on quality control, to make sure that engagement team members are in compliance with independence and ethical requirements applicable to the particular engagement. ■