How the New Ethics Code Will Affect Your Standards

An Interview with Stavros Thomadakis, IESBA Chair

Given the recent spate of financial and accounting scandals, greater attention has been placed on the importance of strong ethical behavior on the part of all CPAs, especially those auditing and advising large corporations. In a recent conversation with *The CPA Journal,* Stavros Thomadakis, PhD, discussed the board's role in ensuring professional accountants around the world adhere to the highest ethical principles. Thomadakis is an emeritus professor of financial economics at the University of Athens who has served as Chair of the International Ethics Standards Board for Accountants (IESBA) since January 1, 2015. He stresses the need for accountants, and for other professionals, to have fundamental ethical principles that they follow.

The following is an edited transcript of the editors' conversation with Thomadakis. An expanded version of this interview, along with that of other contributors from the IESBA, is featured in our Voices of the Profession online video series (http://www.cpajournal.com/category/videos-media).

The Accountant's Mindset

The CPA Journal: CPAs are often considered to be among the most trusted professionals by the public. If they do try to act professionally, is it really necessary for them to have a code of ethics?

Stavros Thomadakis: They do need an ethics code because acting professionally must be made a little more specific, especially for a function or a role like that of the professional accountant. People expect the professional accountant to fulfill certain criteria in order to be trusted. In order to be trusted, you need to have fundamental ethical principles that you follow. That is what the ethics code is about.

At the IESBA, we take special care that the code covers all the areas into which professional accountants are employed. Of course, there is a large area that is called audit and auditors. That is a primary area, if you will, into which the code goes. But also, there is a very wide variety of roles for professional accountants in business or professional accountants in government and in various consulting roles.

CPAJ: CPAs are accustomed to exercising professional skepticism—how important is this to a code of ethics?

Thomadakis: Professional skepticism is an interesting term because skepticism is a Greek word. Skepticism, according to the ancient philosophers, was a notion that had to do with doubt and criticism. That notion is carried over to our present-day understanding of professional skepticism. But the ancients had the piece of wisdom here that there is a line between constructive skepticism and destructive skepticism.

Constructive skepticism means that there is a healthy amount of doubt, criticism, and challenge, but within a certain limit. That is not always easy to get, but that is one of the challenges that the accountant has to face. Now, skepticism is something that is very strongly embodied in the international standards of audit. Skepticism is a primary quality for the auditor, who is supposed to be the guardian of the integrity of financial statements. We think, from our perspective, that skepticism, not necessarily to the degree that it is true in audit practice, but perhaps a lesser version of skepticism, should apply to a professional accountant.

Because all professional accountants, one way or another, have to do with facts, with numbers, and have to certify the validity of evidence—the preparers, the consultants, whoever. Hence, we think that skepticism—or at least, the underlying concept: the mindset of questioning, of challenging, of verifying—must be there for all professional accountants. And that is the line that we will be pursuing in our new planning. And it is part of our response to the challenge of rising public expectations about the accounting profession, because that is what it is.

The IESBA

CPAJ: The IESBA develops and issues the "Code of Ethics for Professional Accountants," which establishes ethical requirements for professional accountants. But it requires each of the 120 member nations to adopt their own ethics codes. How does this process work?

Thomadakis: Many of the national codes of professional conduct, such as the Canadian and the U.S. one and in other jurisdictions, are really based on the international Code of Ethics for Professional Accountants. But the global code is a code for use around the world, and therefore it is a principles-based code. It has a very strong conceptual framework and fundamental principles.

We make the standards, but we have no power to enforce the adoption of the standards. We depend on national standards setters and national decision-making bodies in various jurisdictions for adoption of the code. That is very important, because people think that we also have the power to police the standards, and we do not. There is no international global police function.

From this flows a great responsibility for the board. The responsibility is to be in touch with national standards setters, to be in touch with stakeholders around the world, so that the standards we propose have global applicability and have relevance to the needs of these various global jurisdictions and audiences.

CPAJ: In addition to the five fundamental principles of integrity, objectivity, professional competence and due care, confidentiality, and professional behavior, accountants must be concerned with the need for independence. How is this expressed in the code?

Thomadakis: The code itself is a document that specializes the application of the fundamental principles in various areas of interest for the practice of the professional accountant. One very important area is the area of auditor independence. Of course, the code devotes a section—a whole section and a set of standards—to the topic of independence. Another one is the behavior of professional accountants in business, and the inducements they may be tempted to in following their practice in doing their job.

The code takes the fundamental principles and seeks to specialize them in areas so that it becomes an effective tool of guidance of behavior for the professional accountants when they take a particular role.

CPAJ: Can you talk about the new International Code of Ethics for Professional Accountants, which takes effect in June 2019?

Thomadakis: The restructured code includes the same fundamental principles that previous versions did, but it has changed the way it has written the conceptual framework. It has changed the way that many standards are expressed. It has changed the way the code is structured. And these are important changes because the newly structured code distinguishes requirements very clearly. In fact, it has requirements in bold type, from what we call application material, which is guidance, examples, and so forth. And this is of course a very important step in terms of clarity.

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Clarity in a global code is very, very important. And the restructuring had as a main goal to provide clarity in this code, which we think it does now. And why is it so important? Because it has to do with successful implementation. If a code is unclear, if a code leaves a lot of margin for interpretation, questions, and doubt, that makes implementation unsuccessful.

We are talking about implementation around the world. We are not just talking about implementation in the United States or English-speaking countries. The code is translated into 39 languages, and this is an additional reason why clarity is very important.

It is not business as usual. And it is imperative for jurisdictions around the world that have adopted the code or converged to the code in the two previous versions to now align to the restructured code, so that we have also harmonization around the world.

Noncompliance with Laws and Regulations (NOCLAR)

CPAJ: In those jurisdictions that have adopted the code, professional accountants—both within enterprises as well as in public practice—are subject to a new global standard on addressing and reporting suspected noncompliance with laws and regulations, known as NOCLAR. Can you explain NOCLAR?

Thomadakis: NOCLAR is part of the revisions of the restructured code. It is a major step forward in terms of giving body to the code's goal to serve the public interest and to look at the accounting profession as a profession that also has to serve the public interest. The reason we worked on this standard—and we worked a long time on this standard because it was not easy to do this—is that there was a perception out there that noncompliance with laws and regulations is a source of very serious dilemmas to the practicing accountant, be he or she an auditor or an accountant in business or government. The standard—and let me say that because many people are worried about this—is not really imposing an obligation on the accountant to go looking for noncompliance. It is a standard that says you cannot ignore noncompliance that you become aware of.

You have to do something. We know that many accountants—auditors or otherwise—have been conflicted when they have become aware of noncompliance. And they did not really know how to respond to it, because the ethics code was silent about this. Clearly, the fundamental principle says you should do something, but you need more guidance. That is precisely what the NOCLAR standard does. It gives guidance by describing a process that either the auditor—and this is the more demanding process for the auditor—or the professional accountant in business have to follow when they become aware of noncompliance with laws and regulations.

The second point is that NOCLAR is not only related to noncompliance that affects the financial statements. It is also related to noncompliance that affects the going concern character of the firm or that may lead to major harm to stakeholders, significant harm. So, the violation of environmental laws, of tax laws, of public health laws.

We have many examples of scandals in those areas covered by NOCLAR. That was my second point: it is not just limited to financial statements. Allied to that point is that NOCLAR responds to many concerns around the world about corruption and bribery. Many international organizations, like the OECD [Organization for Economic Cooperation and Development], for example, have welcomed the standard because it is very vital, not only for the practice of accountants in business, but also in the public sector and governments.

My third point is the basic process. NOCLAR says that, for an auditor, when becoming aware and when completing some fact finding to see whether there is potential substantial harm, his or her first obligation is to notify management or those in charge of governance within the organization and ask them to mitigate or to correct the noncompliance. The next step is to evaluate that response. And the following step is to make a decision about whether further actions are needed. And then, at that point, there is of course the option of disclosing, not to the public but to a relevant public authority, assuming there is one.

Now, that is one route, but this may be difficult for a variety of reasons. In that case, the standard says that the accountant has the option to resign from the engagement, but also has the obligation to inform the reason for this resignation to his successor.

This is the way the standard is structured. I would urge people to read it carefully because sometimes impressions are facile and one has to see how the standard is structured to take into account items such as the risk of litigation and the protection that the accountant or the auditor has from litigation.

There is clearly a need flowing from the standard for government to make sure that there is whistleblower protection or other legal protection for the accountant who proceeds with these steps. That is one factor. In some jurisdictions, there may be a factor of personal safety. Clearly, this must be taken into account.

The standard is well thought out. It is very balanced. It is very proportional, but it lays out a clear path, which is in the public interest. It offers support to the ethical accountant who is faced with this dilemma and wants to know a way in which to proceed.

The point I am making is that, even in jurisdictions where there preexists a disclosure to public authority standard, NOCLAR still gives guidance about the way to follow and the steps to follow. So, it is useful, even in those jurisdictions where the law says a phrase or a sentence: “You have to disclose upon those conditions.” This gives a guide as to how to proceed.

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Lastly, and this has to do with conversations around the world about NOCLAR, because everybody is concerned and everybody has confidentiality laws, let me come to this issue of confidentiality. Confidentiality is one of the fundamental principles in the code. But, of course, it is not the intention of the fundamental principles to say that confidentiality is the way to cover up noncompliance. That would not be an ethical principle. Confidentiality is something that, if it creates a dilemma to the ethical accountant whether to do this or to do that, requires guidance. We believe the standard offers the guidance. But it is true that, in some jurisdictions, there are confidentiality laws that say: “You cannot break confidentiality.” The standard can still be used, because it includes many other things, especially the first part of the process where you inform management and ask management to correct or mitigate noncompliance. We encourage various jurisdictions around the world, including here in the United States, to adopt the standard, so that you can at least apply that part that does not have to do with disclosure to a public authority. And at the same time, we urge governments to relent on the confidentiality as a legal restriction in cases where bypassing confidentiality clearly serves the public interest.

CPAJ: CPAs are somewhat unique among professionals in that their client is ultimately the public interest. How does that affect confidentiality?

Thomadakis: I must ask: who is the client of the auditor? The client of the auditor is not necessarily management. They pay him, yes, but the client is the investors, the stakeholders.

Confidentiality for auditors is not what we usually say. The client is the stakeholders. And it is precisely the stakeholders whom NOCLAR is trying to protect.

The Future Agenda

CPAJ: What do you anticipate for the IESBA’s future agenda?

Thomadakis: After having finished the restructured code, we are at a point where we are trying to look at the future and see what are the most challenging items that the ethics code has confronted or, let me say it better, the most challenging items in the accounting practice by accounting professionals in the years to come.

There are two areas which I think all of us will agree are areas of challenge. One is technology and the technology that is used in various ways in accounting practice. The other is public expectations. Public expectations are changing, and there is a general feeling that expectations of ethical behavior are rising. And that is our planning horizon at this point—what we should be doing over the next five years to respond in a relevant way to these areas of challenge.

Ethics will become even more important, because technology can sometimes blind you to ethical dilemmas; that is the sort of thing we are trying to tackle. ❑