

New ethical standard gives new meaning on acting in the public interest

In December 2016, the Institute issued a new ethical standard, *Responding to Non-Compliance with Laws and Regulations*, following the International Ethics Standards Board for Accountants' equivalent standard. The standard, effective on 15 July 2017, sets out a framework that guides auditors and other professional accountants on what actions to take in the public interest when they become aware of a potential illegal act, known as non-compliance with laws and regulations or NOCLAR, committed by a client or employer.

The new standard not only raises the ethical bar for the global accountancy profession, it also reinforces the public interest role that professional accountants play in helping to protect stakeholders and the general public from substantial harm that may arise from breaches of laws and regulations, and in creating more accountable organizations.

What is NOCLAR?

NOCLAR is defined as any act of omission or commission, intentional or unintentional, committed by a client or employer, including by management or by others working for or under the direction of the client or employer, which is contrary to prevailing laws or regulations.

The laws and regulations covered by the standard are those that directly affect the client's or the employing organization's financial statements or its business in a material or fundamental way. Examples of laws and regulations covered by the standard include those that deal with fraud, corruption and bribery, money laundering, tax payments,

financial products and services, environmental protection, and public health and safety. Matters that are clearly inconsequential or personal misconduct unrelated to the business activities of the client or employer are not in scope.

Who will be affected by the standard?

The standard applies to all professional accountants, including auditors, other professional accountants in public practice, and professional accountants in business. Under the Institute's *Code of Ethics for Professional Accountants*, professional accountant in business is defined as a professional accountant employed or engaged in an executive or non-executive capacity in such areas as commerce, industry, service, the public sector, education, the not-for-profit sector, regulatory bodies or professional bodies, or a professional accountant contracted by such entities.

Those with whom professional accountants may raise NOCLAR matters will also be directly affected – including those in management positions, boards of directors, regulators and other public authorities.

What are the new requirements?

The basic ethical principles are the same for all professional accountants, i.e. they should respond to identified or suspected NOCLAR and not turn a blind eye. Nevertheless, the Institute is aware of the different roles and categories of professional accountants, and the different spheres of influence and levels of seniority. Accordingly, the framework set out in the standard

specifies a differential approach to responding to NOCLAR for the following four broad categories of professional accountants:

- Auditors
- Other professional accountants in public practice
- PAIBs who are in senior-level roles, e.g. directors, officers or senior employees in their employing organizations
- Other PAIBs

Under the framework, auditors and senior-level PAIBs have a greater responsibility to take action to respond to identified or suspected NOCLAR compared to other professional accountants.

Both auditors and senior-level PAIBs are required to report identified or suspected NOCLAR to management and, where appropriate, those charged with governance to prompt them to take timely actions. They are also required to determine whether further action is needed after considering the appropriateness of the response of management and those charged with governance and other factors set out in the standard. Further action may include reporting to an appropriate authority outside the entity. The standard specifies that such reports would not be considered as a breach of the duty of confidentiality under the code.

The framework also places renewed emphasis on the role of senior-level PAIBs in promoting a culture of compliance with laws and regulations and prevention of NOCLAR within their organizations.

Key requirements of the new ethical standard are summarized in the tables below:

What is required of auditors under the framework?	
<p>Raise the identified or suspected NOCLAR with management and, where appropriate, those charged with governance</p> <ul style="list-style-type: none"> To clarify their understanding of the matter, to substantiate/dispel their concerns, and to enable management and those charged with governance to investigate it. To advise management and those charged with governance to address the consequences, deter the NOCLAR, disclose the matter to an appropriate authority where required by law or regulation or where necessary in the public interest. <p>Fulfill professional responsibilities</p> <ul style="list-style-type: none"> Understand and comply with applicable laws and regulations. Comply with applicable auditing standards. Communicate the matter appropriately in the context of a group. 	<p>Determine if further action is needed</p> <ul style="list-style-type: none"> Assess appropriateness of the response of management and those charged with governance. In light of that response, determine if further action is needed in the public interest. <p>The nature and extent of further action needed will depend on various factors, e.g.:</p> <ul style="list-style-type: none"> Credible evidence of substantial harm to the entity or stakeholders. Any law prohibiting disclosure of confidential information to an outside party. <p>Courses of further action may include:</p> <ul style="list-style-type: none"> Disclosing the matter to an appropriate authority even if not required by law. Withdrawing from the engagement and client relationship. If withdrawing, inform proposed successor of the NOCLAR. <p>Document courses of action considered, judgment made, and decisions taken.</p>

What is required of senior-level PAIBs under the framework?	
<p>Overarching expectations</p> <ul style="list-style-type: none"> Set the right tone at the top within the organization. Establish appropriate policies and procedures to prevent NOCLAR, including whistleblowing procedures. <p>Fulfill professional responsibilities</p> <ul style="list-style-type: none"> Raise the identified or suspected NOCLAR with a superior and, where appropriate, those charged with governance. Understand and comply with applicable laws and regulations. Rectify, remediate, or mitigate consequences. Reduce the risk of re-occurrence. Seek to deter the NOCLAR. Determine whether disclosure to external auditor is needed. <p>Determine if further action is needed</p> <ul style="list-style-type: none"> Assess appropriateness of the response of superiors 	<p>and those charged with governance.</p> <ul style="list-style-type: none"> In light of that response, determine if further action is needed in the public interest. <p>The nature and extent of further action needed will depend on various factors, e.g.:</p> <ul style="list-style-type: none"> Credible evidence of substantial harm to the entity or stakeholders. Any law prohibiting disclosure of confidential information to an outside party. <p>Courses of further action may include:</p> <ul style="list-style-type: none"> Informing management of the parent entity in the case of a member of a group. Disclosing the matter to an appropriate authority even if not required by law. Resigning from the employment relationship. <p>Documentation is encouraged.</p>

What is required of other professional accountants in public practice and other PAIBs?

Professional accountants in public practice other than auditors

- Discuss with management and, where appropriate, those charged with governance.
- If the client is also an audit client or a component of an audit client of the firm, communicate the matter within the firm.
- If the client is an audit client or a component of an audit client of a network firm, consider communicating the matter to the network firm.
- For any other client, consider communicating the matter to the firm that is the external auditor.

Stand back

- Consider whether further action is needed in the public interest.

Courses of further action may include:

- Disclosing the matter to an appropriate authority even if not required by law.
- Withdrawing from the engagement and client relationship.

The nature and extent of further action will depend on various factors.

Other PAIBs

- Escalate the identified or suspected NOCLAR to the immediate superior or next higher level of authority; or
- Use established internal whistleblowing mechanism.

Documentation is encouraged for both professional accountants in public practice other than auditors, and other PAIBs.

(Source: IESBA's At A Glance in July 2016)

While the new standard has merits, there may be challenges in application. The response framework requires auditors and senior-level PAIBs to determine whether further action is needed in the public interest by considering various factors set out in the standard. Professional judgment is therefore required to make such a decision based on the facts and circumstances pertaining to the cases. In most circumstances, such decision would not be easy and straightforward as it involves both professional conduct and legal considerations.

Professional accountants are advised to consult internally and/or seek external legal or other professional advice if in doubt.

Institute support

The Institute has a complaint mechanism in which professional accountants can lodge complaints concerning the ethical and professional conduct of Institute members and member practices. For any suspected fraud, unlawful acts and malpractices concerning a client or employer, they should consider reporting to the relevant regulators.

The Institute's new and major standards resource centre contains relevant guidance and materials for implementing the new ethical standard. Also, more Institute seminars will be held soon. Contact the Institute's Standard Setting Department (outreachhk@hki CPA.org.hk) if you have any questions on the new standard or any responses to NOCLAR.



This article is contributed by the Institute's Standard Setting Department.