# Proposed Revised Code of Ethics for Indian CAs— Keeping Pace with the Changing Times


***Ethics is the cornerstone of the Chartered Accountancy Profession. In a contemporary society, a person who wants to be successful and stand tall, and maintain such stature in the long run, should understand that he has to subscribe to the ethical norms consistently. A single instance of unethical behaviour, howsoever small it is, could tarnish and damage the reputation built over a period of time. With the changing business environment and increasing complexities, the ethical dilemmas faced by an accountant today are different from that faced by him, say a decade ago. Accordingly, it has become imperative to revise the ethical framework for chartered accountants to keep pace with the changing dynamics of the profession. Keeping in mind the changing requirements and the responsibilities of the Chartered Accountant, the Exposure Draft of the proposed Code of Ethics has been released by ICAI on 8th October, 2018 with the last date for comments being 7th November, 2018. Read on to know more…***

It is the responsibility of a Chartered Accountant to act in public interest and not just to satisfy the needs of an individual client or employing organisation. A chartered accountant has a very big responsibility of coming true to the expectations of Government, other stakeholders, as well as the general public. The coveted position enjoyed by them in the world of finance is because of one important word – credibility. This position, therefore, cannot be taken for granted and it has to be nurtured with constant uncompromising compliance with ethical conduct.

(Contributed by Ethical Standards Board Secretariat of the ICAI. Comments can be sent to esb@icai.in)

Recognising this need, the Institute of Chartered Accountants of India (ICAI) issued 'Code of Ethics'

long back, which deals with various ethical and related matters, which a Chartered Accountant should follow.

With the changing business environment and increasing complexities, the ethical dilemmas faced by an accountant today are different from that faced by him, say a decade ago. Accordingly, it has become imperative to revise the ethical framework for chartered accountants to keep pace with the changing dynamics of the profession. Additionally, the independence and ethical requirements under various regulations have also undergone significant changes necessitating the changes to be reflected in the Code as well.

Keeping in mind the changing requirements and the responsibilities of the Chartered Accountant, the Exposure Draft of the proposed Code of Ethics has been released by ICAI on 8th October, 2018 with a last date for comments being 7th November, 2018.

As a historical background, in November 1963, the Council of ICAI brought the first edition of the *'Code of Conduct'*, which was essentially a set of professional ethical standards regulating the relationship of Chartered Accountants with others. It was renamed as *'Code of Ethics'* for the first time in its ninth edition in 2001. To keep pace with changing times and due to overarching importance of Code of Ethics to the profession, it is revised by Ethical Standards Board from time to time.

The current (2009) edition of the Code of Ethics is the eleventh edition of Code. This edition, for the first time, brought the provisions of Code of Ethics issued by International Federation of Accountants (IFAC)/ International Ethics Standards Board for Accountants (IESBA). The said provisions were incorporated in Part-A of the Code, while the additional provisions governing Chartered Accountants were incorporated in Part-B.

Post 2009, IESBA has issued revised editions of its Code of Ethics, bringing about certain changes. The latest edition of IESBA Code is its 2018 edition, which has brought many substantive and structural changes in the Code. The exposure draft of the revised code is based on the 2018 IESBA Code and contains revisions to Part A of the Code, with a convergence to align with Companies Act, 2013, Chartered Accountants Act, 1949, local practices and our jurisdictional requirements.

**The latest edition of IESBA Code is its 2018 edition, which has brought many substantive and structural changes in the Code. The exposure draft of the revised ICAI code of Ethics is based on the 2018 IESBA Code and contains revisions to Part A of the Code, with a convergence to align with Companies Act, 2013, Chartered Accountants Act, 1949, local practices and our jurisdictional requirements.**

While the exposure draft of the revised Code retains the fundamental ethics principles from the existing code of 2009, it covers refreshed approach and contains certain additional requirements, as detailed below.

## Highlights of Certain Provisions of the Draft Revised Code

1. **Drafting conventions redefined**

   One of the important changes that should be noted by members is the change in drafting conventions, which clarifies the implications of certain phrases used. For instance, it clarifies that the use of phrase "shall' implies compliance. Certain provisions are designated as "Requirement", and hence, include "shall". On the other hand, in some situations, the Code provides a specific exception to a requirement. In such a situation, the provision is designated with the letter "R" but uses "may" or conditional wording. As the Part-A of existing Code of Ethics contains "should", there is a clear change. "Should" implies a duty or obligation, but does not fall under the purview of mandatory requirement. On the other hand, 'shall' imposes an obligation on a member to comply with a specific provision. The new IESBA Code accordingly places the word "shall" with all provisions mentioned as "Requirement".

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2. **Revised Structure of the Code (as proposed by the Exposure Draft)**

   The revised Code is proposed to be divided into following parts:

Part 1 (Section 100-199) – Complying with the Code, Fundamental Principles and Conceptual Framework.

Part 2 (Section 200-299) – Chartered Accountants in Service. Also applicable to chartered accountants in public practice when performing professional activities pursuant to their relationship with the firm.

Part 3 (Section 300-399) – Chartered Accountants in Public Practice

Part 4A (Section 400-899) – Independence for Audit and Review Engagements

Part 4B (Sections 900-999) - Independence for Assurance Engagement other than Audit and Review Engagements

The existing code contains Section 290 (Independence –Assurance Engagements), which has now been split into Part 4A and Part 4B and referred to as 'Independence Standards'.

**3. Structure of each section of the proposed code:**

Each section is structured, where appropriate, as follows:-

- Introduction – sets out the subject matter addressed within the Section, and introduces the requirements and application material in the context of the conceptual framework. Introductory material contains information including explanation of terms used, which is important to the understanding, and application of each part, and its Sections
- Requirements - Establish general and specific obligations with respect to the subject matter addressed
- Application material – provides context, explanations, suggestions for actions, or matters to consider, illustrations and other guidance to assist in complying with the requirements

**4. Additional terms defined**

Some of the additional terms as per the proposed code are as follows.

**(a) Public Interest Entity (PIE)** - The term public interest entity has been defined. Besides listed entities, the proposed Code includes Banks and Insurance companies as part of this definition. It may be noted that additional restrictions apply in case of PIE audit clients which have been discussed later.

**(b) Key Audit Partner** - The Code introduces a new term 'Key Audit Partner'.
Key Audit Partner is defined as: The engagement partner, the individual responsible for the engagement quality control review, and other audit partners, if any, on the engagement team who make key decisions or judgments on significant matters with respect to the audit of the financial statements on which the firm will express an opinion. Depending upon the circumstances and the role of the individuals on the audit, "other audit partners" might include, for example, audit partners responsible for significant subsidiaries or divisions.

**The draft Revised Code of Ethics introduces a new term 'Key Audit Partner'. Key Audit Partner is defined as: *The engagement partner, the individual responsible for the engagement quality control review, and other audit partners, if any, on the engagement team who make key decisions or judgments on significant matters with respect to the audit of the financial statements on which the firm will express an opinion.***

While on the definition of Key Audit Partner, it may also be noted that the following provisions additionally apply to the Key Audit Partner:

- Compensation and evaluation policies – which restrict evaluating and compensating such partner based on success in selling non-assurance services to his/ her audit client.
- Cool off period prescribed before such partner enters into employment relationship with his/ her audit client
- Provisions relation to long association of personnel/ partner rotation

**(c) Relative :** The term 'relative' as defined in the Companies Act, 2013 has been incorporated in the proposed Code for the purpose of applicable independence provisions under the Companies Act, 2013, which apply to relatives of partner or sole proprietor.

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(d) **Immediate family and close family :** The terms has been introduced for application of personal independence restrictions.

'Immediate family' is defined as: Spouse (or equivalent) or dependent.

'Close family' is defined as: A parent, child or sibling who is not an immediate family member.

It may be noted that the existing code uses the term 'Relative' for application of independence restrictions. In lieu of the term 'Relative', the independence restrictions shall now apply to 'immediate family' and 'close family'.

(e) **Non-compliance with laws and regulations (NOCLAR):**

This definition is relevant in the context of the new provisions included in the proposed Code which provide a framework to guide Chartered Accountants in deciding how best to act in public interest when they become aware of NOCLAR or suspected NOCLAR.

NOCLAR: Comprises acts of omission or commission, intentional or unintentional, which are contrary to the prevailing laws or regulations committed by the following parties:

- The Chartered Accountant's employing organization/ the client, as applicable;
- Those charged with governance of the employing organization/ the client, as applicable;
- Management of the employing organization/ the client, as applicable; or
- Other individuals working for or under the direction of the employing organization/ the client, as applicable

**5. Preparation and Presentation of Information**

The proposed Code introduces a new section for Chartered Accountants in service considering the fundamental and crucial role played by such accountants in the financial reporting supply chain and facilitating effective governance in organisations. The provisions contains:

- comprehensive provisions addressing responsibilities of chartered accountants in service when preparing or presenting information;
- Prohibition on exercising discretion when preparing or presenting information with intent to mislead or inappropriately influence contractual or regulatory outcomes;
- Guidance to assist chartered accountants in disassociating from misleading information

**6. Inducements, including gifts and hospitality (Section 250 and 340)**

The proposed Code contains enhanced description of inducements with a view to respond to continuing concerns about bribery and corruption. Other revisions include:

- Emphasis on chartered accountant's responsibility to comply with the relevant laws and regulations related to bribery and corruption when offering or being offered inducements,
- Prohibition on inducements made with intent to improperly influence the behavior of the recipients;
- Providing additional guidance on offering or acceptance of inducements by immediate or close family member.

**7. Non Compliance with Laws and Regulations (NOCLAR)**

The NOCLAR provisions affect all Chartered Accountants, whether in public practice providing any professional services to clients, or whether in service carrying out professional activities for an employing organisation.

The proposed Code establishes a comprehensive response framework that guides a Chartered Accountant in terms of the factors to consider and the steps to be taken when he/she becomes aware of NOCLAR or suspected NOCLAR.

The proposed Code contains new section on NOCLAR for both members in service (Section 260) and members in public practice (Section 360). It may be noted that Section 360 is proposed to be made applicable in relation to audit engagements for listed entities only.

The proposed Code provides guidance in assessing the implications of non-compliance or suspected non-compliance with laws and regulations where the accountant becomes aware of such non-compliances in the course of carrying out professional activities and the possible courses of action when responding to non-compliance or suspected non-compliance with:

(a) Laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the employing organization's financial statements/ the client financial statements, as applicable; and

(b) Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the employing organization's financial statements/ the client financial statements, as applicable, but compliance with which might be fundamental to the operating aspects of the employing organization's business/ client's business (as applicable), to its ability to continue its business, or to avoid material penalties.

Additional guidance is provided with respect to obtaining an understanding of the matter, addressing the matter and determining whether further action is needed.

Further action could include, among other actions, the reporting of a matter to an appropriate authority under the appropriate circumstances, after consideration of a range of factors, including the appropriateness of the response of management and, where applicable, those charged with governance.

This is a significant change which would result into enhanced reporting responsibilities for a Chartered Accountant.

**8. Stronger independence provisions concerning long association of personnel with audit clients**

The current code prescribes that the Engagement Partner and the Engagement Quality Control Reviewer on a listed audit client shall rotate after seven years and serve a cooling off period of two years. Some of the proposed revisions to the existing requirements are as follows:

- Partner rotation requirements extended to Key Audit Partners on PIEs
- Key Audit Partners in respect of a PIE audit client are required to rotate after seven years.
- Revised cooling off period for Key Audit Partner:
  - ✓ Engagement partner - Five consecutive years.
  - ✓ Engagement quality control reviewer - Three consecutive years.
  - ✓ Other key audit partner - Two consecutive years.

**9. Breach of the requirements of the Code**

The proposed Code seeks to establish a more robust framework for addressing a breach of the requirements of the Code.

The new proposals include requiring a firm to

- End, suspend or eliminate the interest or relationship that caused the breach;
- Evaluate the significance of the breach and determine whether action can be taken
- Communicate all breaches with those charged with governance and obtain their concurrence regarding actions taken
- Document the conclusions drawn on account of the breach

**10. Management Responsibilities**

The proposed Code seeks to introduce a new section dealing with 'Management Responsibilities'. The proposed Code contains a description of activities that would, and would not, be generally regarded as a management responsibility and includes enhanced guidance regarding how the auditor can better satisfy itself that client management will make all judgments and decisions that are the responsibility of management, when the auditor provides non-assurance services to an audit client.

It may be noted that Management Responsibilities as mentioned in the draft Code are not the same as 'Management Services' mentioned under Section 144 of the Companies Act, 2013.

**11. Compensation and evaluation policies**

A new requirement is proposed to be included restricting audit team members and Key Audit Partners from being compensated for selling non-assurance services to audit clients

**12. Mergers and Acquisitions**

The proposed Code introduces new requirements and applicable guidance addressing situations where, as a result of a merger or acquisition, an entity becomes a related entity of an audit client, to assist the Chartered Accountant in evaluating previous or current interests and relationships with the related entity that might affect independence and ability to continue the audit engagement.

**13. Tax Services**

The proposed Code contains new provisions relating to threats that are created by certain tax services. The provisions also contain additional restrictions for PIE audit clients. The provisions address tax services which are generally permissible to be carried out by a member and also explain the threat to independence where

certain tax services may be not be permitted in case of PIE audit clients.

**14. Fee- Relative Size**

The proposed Code introduces a new requirement where the total gross annual professional fees from the audit client and its related entities exceed 15% of the total fees of the firm. In such situation, the Code requires the firm to make a disclosure to those charged with governance of the audit client and discuss whether certain safeguards provided in the Code may be applied (such as a pre-issuance or a post issuance review).

Such ceiling on the total fees of the Firm shall not be applicable where such fees do not exceed five lakhs of rupees in respect of a firm including fees received by the firm for other services rendered through the medium of a different firm or firms in which such member or firm may be a partner or proprietor.

Such ceiling on the total fees of a Firm shall not be applicable in the case of audit of government Companies, public undertakings, nationalised banks, public financial institutions or where appointments of auditors are made by the Government.

**15. Introduction of additional restrictions applicable to Public Interest Entity (PIE) audit clients**

Certain additional restrictions stated in the proposed Code apply only in relation to PIE audit clients which are summarized below:

**(a) Employment with an audit client – Cooling Off**

A new provision has been included which requires a cooling off period before a Key Audit Partner or the firm's Managing Partner (Chief Executive or equivalent) joins an audit client that is a PIE as:

- a Director or Officer, or
- an employee in a position to exert significant influence over the preparation of the accounting records or the financial statements on which firm will express an opinion

Cooling off period:

– In case of a key audit partner: one audit opinion covering a period of not less than twelve months should be issued for which the partner was not a member of the audit team

– In case of the firm's Managing Partner (Chief Executive or equivalent), twelve months should have been passed since the individual was in that role

**(b) Long Association of personnel**

As stated earlier, the current code contains provisions related to long association of personnel with audit client. In the proposed Code, the same will get extended to PIEs. The broad provisions have been explained in earlier paragraphs of this article.

**(c) Non-assurance services to Audit client**

Additional restrictions apply to PIE audit client in case of certain non-assurance services such as valuation services, tax services, information technology system services.

**15. Local regulatory requirements**

A new section on Auditor rotation is proposed to be included specifying rotation requirements under various local regulations such as the Companies Act, 2013, RBI, SEBI requirements etc.

Partner rotation requirements under various regulations such as those applicable to NBFC, HFCs etc. have been summarized in the section on long association of personnel with an audit client.

Additional independence requirements under Companies Act, 2013 and Income tax Act, 1961, have been specified at relevant sections of the Code.

**16 Independence for assurance engagements other than audit and review engagements:**

A new section included on Independence requirements for assurance engagements has been included.

It should be the endeavour of all the chartered accountants to embrace the changes proposed by the revised Code in meeting the objectives of the profession to act in public interest and work to the highest standards of professionalism. Since the exposure draft containing various new/ revised proposals has been issued for comments, the members are encouraged to send their comments, if any, to the ICAI so that these can be considered before issuance of the final Code. It is proposed that the revised Code will be effective from 1st April, 2019. ■