

IESBA Cover letter

Part C of the International Ethics Standards Board for Accountants (IESBA) Code provides ethical guidance to professional accountants in business.

In early 2012, the IESBA formed a working group to analyze reported accounting irregularities at certain companies and determine whether Part C should be strengthened to better promote ethical behavior by PAIBs. As part of its effort, the working group undertook an informal preliminary survey of a number of IFAC member bodies whose memberships comprise a large number of PAIBs, including member bodies from both developed and developing nations. The survey attempted to identify the types of ethical issues and problems encountered by the member bodies' PAIBs.

We now wish to investigate further the results of the preliminary survey mentioned above. This is explained in further detail below.

We would be grateful if you could, in consultation with a relevant PAIB committee or Board within your organization as appropriate, rate the importance of, and rank, the potential issues we have identified to date. Please add any comments or examples you may wish to provide. We would also welcome suggestions for any significant issues you may wish to add to the list.

We recognize that August is not an ideal month for such work in some jurisdictions, but would appreciate your best endeavors to **reply by 22 August**.

If you have any questions please contact chrisjackson@ifac.org

Review of Part C of the Code

Background

At its June meeting, the International Ethics Standards Board for Accountants (IESBA) supported the tentative proposals made by the working group. The June report was based on the survey of member bodies that asked them:

- what issues their business members raised with them, that they would like to be addressed,
- what ethical guidance they provided in addition to Part C,
- how Part C could be enhanced?

The report to the IESBA proposed two main issues for the board to address and noted some other less critical issues. The Board requested a more comprehensive list of issues for consideration at its December 2012 meeting. This comprehensive list would help inform the IESBA's strategy for 2014 and onwards. To develop this list, the working group proposes to compile a high level list (see below) based on the work undertaken to date and comments made at the board meeting. The working group will prioritize the list based on input from: member bodies, the IESBA Consultative Advisory Group and the PAIB Committee of IFAC. The preliminary survey asked member bodies to identify relevant issues. This survey asks for priorities and comments on those issues. The working group will judge which issues merit being more fully scoped for consideration by the IESBA in December.

In addition to making recommendations to the Board about which issues should be given the highest priority, the working group will make recommendations about the form that additional guidance might take. The most appropriate way may be through changes to the Code, the drafting of staff Q&As or other means. For this reason, comments on how issues should be addressed are welcome.

In order to aid the working group in developing recommendations to the Board about issues relating to Part C that should be included in its strategy/work plan for 2014/2015, please respond to the following items:

1. Please rate the importance of each issue for PAIBs on a 1 to 6 scale, with 1 being extremely important and 6 being not important at all
2. Please add any further issues at the foot of the table, and rate their importance and priority.

Background information explaining each issue is described below.

References to paragraphs in the Code can be found at [IESBA Code](#)

	Issue	Rate Importance on a scale of 1 (extremely important) to 6 (not important at all)
A	<i>Pressure from superiors to engage in unethical or illegal acts</i>	1
B	<i>Responsibility to produce truthful information and reports</i>	1
C	<i>Requirement to disassociate from misleading information</i>	1
D	<i>Facilitation payments and bribes (Inducements offered and received)</i>	3
E	<i>Conflicting Business Partner vs. Controller roles</i>	2
F	<i>Specific guidance relevant to professional accountants in the public sector</i>	2
G	<i>Applicability of Part C to professional accountants in public practice</i>	5
H	<i>Advocacy threats to fundamental principles</i>	4
I	<i>Independence requirements for professional accountants who are not in public practice who perform assurance engagements</i>	5
	Please add any further issues (the boxes will expand to accommodate your issue)	
J	<i>Structured approach to decision making</i> (refer below for detailed comments)	2
K	<i>Fair valuations of assets and liabilities in accordance with International Financial Reporting Standards(IFRS)</i> (refer below for detailed comments)	1
L	<i>The impact of remuneration structures such as bonuses, shares and share options on the behaviour of PAIBs</i>	1

3. Because of the Board’s limited resources, the working group will make recommendations about the priority of these issues to include in the Board’s strategy and plan for 2014/2015. Please rank the priority of your top five issues from the above list.

The Board should give issue A, B and C the highest priority

The Board should give issue E and F the second highest priority

The Board should give issue D the third highest priority

The Board should give issue H the fourth highest priority

The Board should give issue G, and I the fifth highest priority

BACKGROUND INFORMATION		
	Issue	Comments and Examples (Please note: These may be quoted in IESBA agenda papers unless you request anonymity)
A	<p><i>Pressure from superiors to engage in unethical or illegal acts</i></p> <p>Background: The survey of member bodies conducted by the working group reveals that the most common inquiry they receive from PAIBs concerns pressure from superiors to engage in unethical or illegal acts.</p> <p>Currently, guidance in the IESBA Code on this matter is included in three sections (310, 320 and 340), although the content in 310, on this issue, is subject to a proposed revision.</p> <p>The working group believes that the references to pressure are too narrowly defined in the following respects:</p> <p>Pressure applies to financial management, tax compliance, and other matters in addition to financial reporting.</p> <p>Pressure to improperly influence earnings is as likely to be the result of the corporate culture, bullying and threats of job loss as much as personal financial gain.</p> <p>Pressure affects many PAIBs in subordinate roles</p>	<p>We agree that Professional Accountants in Business (PAIBs) are subject to a unique set of circumstances which places additional pressure on PAIBs’ ability to comply with the fundamental principles of the Code.</p> <p>In Australia to provide further guidance to PAIBs the APESB issued APES GN 40 <i>Ethical Conflicts in the Workplace – Considerations for Members in Business</i> (GN 40).</p> <p>This guidance note provides additional guidance for PAIBs on the application of the fundamental principles of the Code supported by 21 examples of ethical conflicts that PAIBs may encounter in the workplace.</p> <p>We agree with the working party view that pressure will be applied in respect of matters other than financial reporting.</p> <p>However, we believe that the existing Code does address matters other than financial reporting (e.g. refer paragraphs 310.2, 320.1 and 320.3.)</p> <p>We agree with the working party that the relationships and pressures</p>

	<p>who are neither directly involved with financial statements of companies nor have a financial interest in the entity nor can influence the preparation of those financial statements. For example, many PAIBs work at a subsidiary level or with management accounts and not in financial reporting in divisional or head offices.</p> <p>Pressures on PAIBs may come from superiors who are also PAIBs, but the Code does not address the responsibilities of superior PAIBs towards others in the context of illegal and unethical acts.</p> <p>So, while Section 340 recognizes that financial interests may create threats to fundamental principles, the working group is of the view that Section 340 is too narrowly described and believes that it could be expanded beyond financial interests to recognize other pressures, especially pressures on subordinate PAIBs, and in the area of financial management in addition to financial reporting. Expanding the threats and combining them under one heading would make the guidance in the Code much clearer.</p>	<p>created by superiors (who may be PAIBs) on subordinate PAIBs who work at the subsidiary level in a consolidated group should be explored further.</p> <p>Recently the APESB also considered whether there should be additional guidance in respect of senior finance roles and management representations in a consolidated group situation. Accordingly, we welcome the IESBA's initiative in this regard to develop further guidance to PAIBs.</p> <p><i>We believe that IESBA's potential projects A, B and C are linked and that it will be difficult to deal with these issues if they are treated as separate projects.</i></p> <p><i>Accordingly we believe that these three projects should be dealt with together and should have priority 1.</i></p> <p><i>These matters should be dealt with as improvements to the existing Code.</i></p>
<p>B</p>	<p><i>Responsibility to produce truthful information and reports</i></p> <p>Background: Paragraph 320.2 requires the PAIB to prepare or approve general purpose financial statements in accordance with applicable financial reporting standards. In addition, paragraph 320.1 requires the PAIB to prepare or present "information fairly, honestly and in accordance with relevant professional standards".</p> <p>The requirement in 320.1 goes beyond presenting financial statements in accordance with the applicable financial reporting standards and creates three additional tests, i.e., that information must be reported:</p> <ul style="list-style-type: none"> • fairly • honestly and • in accordance with relevant professional standards <p>Further guidance may be useful on how to judge the "fairness and honesty" of financial statements</p>	<p>We agree that a major role of PAIBs involves the preparation of management and other financial reports that may subsequently be used by external parties. Therefore it is important that information and analysis contained within such reports are in accordance with the applicable financial reporting frameworks and is presented fairly and honestly. We believe that guidance on how to judge "fairness and honesty" would be useful.</p> <p>The Code does not specifically address the situation of manipulation of data to justify management decisions. However, it would be useful for the proposed guidance to elaborate on potential threats that gives rise to a breach of the fundamental principles of the Code. By providing the PAIB with</p>

	<p>that already comply with financial reporting standards.</p> <p>The proposed addition of Section 360 (Exposure Draft on Responding to a Suspected Illegal Act) includes a brief mention of “improper earnings management or balance sheet valuations” as an amendment to section 300.6. Additional guidance could be added to the Code on “improper earnings management”.</p> <p>A major role of the PAIB is financial management, including budgeting, preparing management accounts and providing decision support. An area in which supervisors may exert pressure on subordinates is the manipulation of data to justify management decisions, e.g. choice of discount rates to achieve a predetermined answer or financial justification for management decisions either before or after the event, or the use of financial models in the preparation of forward looking statements, plans and budgets.</p> <p>The Code recognizes in Section 320 that management information is included within the definition of Information. However the Code does not address the manipulation of data to justify management decisions.</p>	<p>guidance on the types of threats that may lead to the preparation of misleading information, the PAIB will be better equipped to address pressures such as the manipulation of data to justify management decisions.</p> <p>PAIBs who prepare management reports for internal decision making should also be mindful of differences (if any) between these reports and the financial reports to be prepared subsequently for statutory reporting purposes.</p> <p>As noted in project A, we believe that IESBA will achieve the best outcome if projects A, B and C are linked and done at the same time.</p>
<p>C</p>	<p><i>Requirement to disassociate from misleading information</i></p> <p>Background:</p> <p>Paragraph 320.6 requires a PAIB to refuse to be associated with or to disassociate themselves from misleading information. No guidance is given on the steps a PAIB should take to disassociate themselves from the information.</p>	<p>PAIBs are not always employed in a position of influence in a company. For example, the PAIB may be employed as a junior member of the finance team. Further the PAIB may not be directly involved in the preparation of financial reports. The focus of the PAIB may be on business units of the company where primary information prepared is in the form of business unit management reports.</p> <p>We agree with the IESBA working party that given the diversity of roles undertaken by PAIBs, guidance on alternative steps that are available to</p>

		<p>PAIBs to disassociate themselves from misleading information would be invaluable.</p> <p>As noted in project A, we believe that IESBA will achieve the best outcome if projects A, B and C are linked and done at the same time.</p>
<p>D</p>	<p><i>Facilitation payments and bribes (Inducements offered and received)</i></p> <p>Section 350 (Inducements) covers both receipts and offers of items of value by PAIBs. These may include gifts, hospitality, preferential treatment etc. Irregularities relating to illegitimate payments appear to be a growing problem, according to a recent survey of professional accountants in business, and as reported in the world press. Section 350 could be reviewed to consider whether the Code appropriately recognizes the diversity of practices in different cultures.</p>	<p>Given the diversity of business practices and traditions in different jurisdictions and cultures we believe that this will be a challenging and time consuming task for IESBA.</p> <p>Companies that elect to trade internationally are commonly aware of generally accepted business practices with their trading partners. While it is important for the Company to ensure business practices adopted are legitimate, more benefit would be provided to PAIBs if they were advised, by way of guidance, to familiarise themselves with company practices and policies in relation to inducements. Where such policies are inconsistent with the requirements of the Code, the PAIB should be provided with advice in terms of safeguards to address the threats of non-compliance with the fundamental principles.</p> <p>We have allocated a priority of 3 to this project as:</p> <ul style="list-style-type: none"> • The Code does addresses it, albeit in a limited manner; • APESB's APES GN 40 has examples on inducements; • In the Australian business environment this is not a significant issue. <p>Taking into consideration IESBA's resource constraints, IESBA could consider dealing with this by way of staff Q&As in the short term until the higher priority projects are dealt with.</p>

<p>E</p>	<p><i>Conflicting Business Partner vs. Controller roles</i></p> <p>Background: The traditional role of the PAIB as controller requires skepticism and objectivity in questioning and challenging others within the employing organisation. In recent years, PAIBs have been encouraged to be a “business partner” and to be part of the team which creates shareholder value. These roles overlap, and may be in conflict to some degree; they thus may provide a challenge for the PAIB who is required to be both an advocate and a skeptic. As an example, a former DG of the European Commission, Jules Muir, stated:</p> <p><i>“Over the last 10 years, many CFOs have carved out such a broad function for themselves that, in my view, they are combining responsibilities that are incompatible with the fundamentals of checks and balances. Many CFOs nowadays are not only responsible for the proper functioning of the controls and for the integrity of the numbers, but they are also major game-makers in their financial management function. You run into a conflict of interest if you combine an obvious management function with the controlling and accounting for it, in particular when the job is strongly bonus-driven.</i></p> <p><i>Therefore, I would strongly favor splitting the CFO role into an officer in charge of ‘bean-making’ and an officer in charge of ‘bean-counting,’ in particular for organisations that have financial management as a stand-alone profit center, such as banks and insurance companies, but also others.”</i></p> <p>The IESBA could consider whether this may be a public interest issue and provide guidance on suitable safeguards to reduce the threat to an acceptable level?</p>	<p>APESB’s GN 40 also deals with potential conflicts that may arise from the obligation of a PAIB to comply with the fundamental principles of the Code whilst fulfilling responsibilities to the Employer. Ordinarily the PAIB is required to support the legitimate and ethical objectives established by the Employer and rules and procedures in support of those objectives. However, as a consequence of responsibilities to the Employer, the PAIB may be under pressure to act or behave in ways that could directly or indirectly threaten compliance with the fundamental principles of the Code.</p> <p>Given the significance of the role of a Controller in a company and the threats that are present where the Controller has conflicting obligations to satisfy as a business partner, guidance relating to management of such threats/conflicts would be very useful.</p> <p>Accordingly, we have allocated a priority of 2 to this project and believe that it would be useful to have the additional guidance included in the existing Code.</p>
<p>F</p>	<p><i>Specific Guidance Relevant to Professional Accountants in the Public Sector</i></p> <p>Background: The IFAC definition of a PAIB is: “A professional accountant employed or engaged in an executive or non-executive capacity in such areas as</p>	<p>The nature of the public sector and its role in the community demands that financial information produced demonstrates qualities of integrity,</p>

	<p>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.” Recent events have raised the issue of the quality of financial information in the public sector, and pressure on professional accountants in the public sector to manipulate financial information.</p> <p>Additional guidance could be added to Part C to reflect the particular threats and safeguards applicable in the public sector.</p>	<p>honesty, fairness and compliance with accounting standards.</p> <p>We agree that recent events in Europe have highlighted the importance of this sector and the role PAIBs play in public sector organisations.</p> <p>Accordingly, we have allocated a priority of 2 to this project and believe that it would be useful for IESBA to develop additional guidance in the existing Code.</p> <p>In the interim IESBA could consider issuing staff Q&As to provide some guidance in recognition of the current market needs in a similar manner to the IAASB.</p>
<p>G</p>	<p><i>Applicability of Part C to Professional Accountants in Public Practice</i></p> <p>Background: Paragraphs 100.3 and 100.12 state that “professional accountants in public practice may also find Part C relevant to their particular circumstances”. Therefore they may be bound by the requirements of Part C as well as Parts A and B. An example of this relevance is that professional accountants in public practice may be inappropriately pressured by superiors to compromise audit quality by working within unrealistic time budgets. This is not addressed in Part B, but is addressed in Part C.</p> <p>Part C could be revised to clarify the relevance of Part C to professional accountants in public practice.</p>	<p>As currently drafted Part C <i>Professional Accountants in Business</i> of the Code is clear in its application to PAIBs.</p> <p>There is a danger in cross referring between the different sections which are generally applicable to different membership classifications (i.e. in public practice or business).</p> <p>If there are matters that should be addressed in respect of all Members in Public Practice it should be included within Sections 200-280.</p> <p>For example, in respect of Conflicts there is section 220 for Members in Public Practice and Section 310 for Members in Business.</p> <p>We have allocated a priority of 5 to this project. IESBA could consider issuing staff Q&As to provide some guidance in recognition of the current market needs in a similar manner to the IAASB.</p>
<p>H</p>	<p><i>Advocacy threats to fundamental principles</i></p> <p>The Code recognizes that a PAIB has a responsibility to further the legitimate aims of the employer. However advocacy may create a threat to the fundamental principles if a PAIB promotes an employer’s position to the point where objectivity is compromised. The fundamental principle of Integrity requires information should not</p>	<p>The nature of forecasts and projections is that they are based on assumptions and estimates which commonly include a level of subjectivity and opinion. Given the potentially subjective nature of the tasks of budgeting and forecasting, guidance in this area is useful to</p>

	<p>omit or obscure information where such omission or obscurity would be misleading.</p> <p>Further guidance could be useful on how these principles apply to commercial negotiations, in presenting forecasts and projections, and agreeing budgets where tactics, positioning and motivational factors may come into play. Many skills applied by PAIBs, e.g. used in commercial negotiation, produce tension with the fundamental principle of objectivity.</p>	<p>ensure the PAIB applies principles that encourage objectivity to produce reports that are not conflicted by management manipulation.</p> <p>The guidance note GN 40 includes some examples on this topic and APESB's APES 315 <i>Compilation of Financial Information</i> encourages PAIBs to use that standard when compiling financial information.</p> <p>Accordingly, in the Australian context we have allocated a priority of 4 to this project.</p>
I	<p><i>Independence Requirements for Professional Accountants who are not in Public Practice who Perform Assurance Engagements</i></p> <p>Sections 290 and 291 of the Code address independence requirements for assurance engagements. The sections apply to professional accountants in public practice. The Code could consider whether guidance is needed on the independence requirements that should apply to other professional accountants who perform assurance engagements, such as accountants in government and internal auditors.</p>	<p>In Australia the definition of Firm has an additional limb (d) which includes the Auditors General. Accordingly all the Auditors General who perform the public sector audits are subject to sections 290 and 291.</p> <p>As internal auditors are employed by the entity we do not believe that they can be independent of the entity so that sections 290 and 291 are not sections to be considered by internal auditors. Potentially you could consider a new section for PAIBs (say 370) that addresses matters to be considered by internal auditors.</p> <p>Accordingly, in the Australian context we have allocated a priority of 5 to this project.</p>

J	<p><i>Structured approach to decision making</i></p>	<p>The Guidance Note GN 40 adopts a structured decision making model (see Section 4 <i>Conceptual Framework Approach</i> of APES GN 40) that PAIBs can use when resolving ethical dilemmas in Australia.</p> <p>A similar framework may be useful for IESBA to include in the Code to provide PAIBs guidance to evaluate ethical conflicts or issues.</p> <p>This issue could potentially be linked with Project E.</p>
K	<p><i>Fair valuations of assets and liabilities in accordance with International Financial Reporting Standards(IFRS)</i></p>	<p>With a significant number of jurisdictions adopting International Financial Reporting Standards (IFRS) the requirement to fair value assets and liabilities has resulted in PAIBs having to make more subjective judgements than under a historical cost model of accounting for assets and liabilities.</p> <p>When making critical judgments and assumptions PAIBs should apply a reasonable third party test and where the matter is not within the PAIB's expertise should consult with a third party who has the relevant expertise (e.g. when valuing complex financial instruments or share options).</p> <p>The use of cash flow models to test for impairment of assets also includes the selection of assumptions and estimates. PAIBs may be under pressure to select certain assumptions and estimates (e.g. interest rates, WACC, commodity prices and FX rates) that deliver a favorable outcome to the entity but may not be in compliance with the IFRS standards.</p> <p>In IESBA's consideration of issues in respect of Projects A and B, we suggest that ethical considerations/conflicts in respect the fair valuation of assets and liabilities be considered.</p>

L	<p><i>The impact of remuneration structures such as bonuses, shares and share options on the behaviour of PAIBs</i></p>	<p>Where the financial results reported by a PAIB will have an impact on whether or not the PAIB will receive additional remuneration this is likely to create a conflict and has the potential to drive inappropriate behaviour.</p> <p>In the last few years the media, the governments of various countries and regulatory agencies have been quite critical of remuneration incentives that drove inappropriate behaviour by finance personnel.</p> <p>In IESBA's consideration of issues in respect of Projects A and B, we suggest that ethical considerations/conflicts in respect remuneration incentives be included.</p>
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