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Dear Mr Siong

**Exposure Draft – Proposed Changes to Part C of the Code Addressing Presentation of Information and Pressure to Breach the Fundamental Principles**

The Financial Reporting Council (FRC) welcomes the opportunity to comment on the proposed changes to the Code of Ethics for Professional Accountants (the Code) set out in the above exposure draft.

Professional accountants in business in the UK are subject to the ethical codes of the UK professional bodies which are based on the IESBA Code. These accountants play a key role in corporate reporting and we agree that it is in the public interest that the provisions of the Code applicable to them are appropriate and robust.

We are supportive of the aims of the IESBA to strengthen Part C of the Code. However, we believe that a number of the proposed changes could be improved and the principles to be complied with emphasised. In particular, the overarching principles should be presented at the start of each section and supporting principles more clearly identified other than just through the use of the term “shall” – for example by the use of appropriate sub-headings before each supporting principle. We also believe that the principles should as far as possible include an outcome based objective. We provide more specific comments below in our answers to the questions asked in the Explanatory Memorandum.

**Proposed Revised Section 320**

*1. Is the enhanced guidance on applying the “fair and honest” principle in Section 320 helpful?*

The first sentence of paragraph 320.2 establishes the overarching principle that a professional accountant shall prepare and present information in manner that is fair and honest, in accordance with the fundamental principles. This is expressed separately from the ‘important factors’ in paragraph 320.4 relating to the purpose, context and users of the information that need to be considered by the professional accountant. We believe that the professional accountant’s ethical responsibilities should be further clarified by including in the overarching principle in this paragraph the objective as to the outcome in terms of the information itself (in terms of the factors addressed in paragraph 320.4). We recommend rewording the overarching principle along the following lines:

“In performing any professional activity that is involved with the preparation or presentation of the employing organisation’s information, the professional accountant shall do so in accordance with the fundamental principles, in a manner that is fair and honest. The objective is to ensure that the information, insofar as the professional accountant is able to influence it, is fair, balanced and understandable and can be trusted by the intended users given the intended purpose and context of its use.”

As this is an overarching principle we believe it would be most appropriate to present it at the start of Section 320. Subheadings should be included before paragraphs 320.5 (e.g. ‘Dependence on the involvement of others in the preparation or presentation of the information’) and 320.6 (e.g. ‘Information that is or may be misleading’).

The supporting guidance in paragraphs 320.1 and 320.2 is intended to explain the variety of such information, and the nature of the professional accountant’s involvement with it, and what is meant by ‘fair and honest’ behaviour. However, there are issues and inconsistencies which give rise to a lack of clarity.

The section has been retitled “Presentation of Information”, whereas the first sentence of paragraph 320.1 refers to being “involved in the **preparation and** presentation of information” (**emphasis** added). Paragraph 320.2 refers to “recording, maintaining, preparing or presenting information”. These phrases imply that each of recording, maintaining, preparing and presenting are exclusive of each other, which may be seen as inconsistent with the new title. We suggest that the term “involved with the preparation or presentation of the employing organisation’s information” should be the general term used, with the title of the section amended accordingly and with guidance providing further explanation of the nature of such information and the nature of such involvement, without narrowing the meaning of the term.

The guidance in paragraphs 320.1 and 320.2 could usefully be broadened to incorporate other ways in which a practitioner may be involved with the preparation or presentation of information<sup>1</sup>. For example, a PAIB may be involved as an audit committee member but this is not covered in the examples. We also believe that it should be made clear that involvement with the preparation or presentation of information includes circumstances where the professional accountant is responsible for ‘approving’ information that has been prepared or presented by others. Further examples of non-financial information may also provide more balance – for example, preliminary announcements, investor presentations, investment or funding proposals, information provided to stakeholders in the context of contractual arrangements (suppliers, banks etc).

In the first bullet point of paragraph 320.2, the specific reference to ‘nor to influence contractual or regulatory outcomes inappropriately’ may appear to unnecessarily restrict the meaning of ‘mislead’, which we believe should encompass intent to inappropriately influence outcomes. We recommend that it would be more appropriate to indicate that behaving fairly and honestly includes “preparing or presenting information that neither misleads nor is intended to mislead (including by inappropriately influencing regulatory, contractual or other outcomes based on the information)”.

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<sup>1</sup> Involvement may range across, for example: initiation (and recording of relevant attributes of) transactions, events and conditions; capture of other information from internal and external sources; processing and maintaining information (including analysing, collating, cross-referencing, summarising, validating, correcting, and updating); developing new outputs based on the information (such as valuations, projections and forecasts); preparing reports or presenting information orally based on the information; designing, implementing, operating or monitoring information systems; overseeing information systems and reports based on outputs from them (e.g. audit committees); and testing and reporting on information systems and outputs (e.g. internal audit).

To be consistent with the first bullet point, the second bullet point should be amended to “not omitting information with the intention or effect of rendering the information misleading”. An alternative way of addressing this could be to indicate that fair and honest presentation requires “including the information necessary for an appropriate understanding by the intended users”.

The first two bullet points as currently drafted are worded to refer to intentional actions that are contrary to fair and honest, but the last (preparing information in accordance with a relevant reporting framework where applicable) is not. The reason for this inconsistency is not clear. The fundamental principle of professional competence and due care should apply in all regards and, therefore, for example, unintentionally preparing and presenting information that is misleading (including information that is inappropriately influential) should be as much of a concern as should preparing and presenting information that is not in accordance with a relevant reporting framework whether intentionally or unintentionally. This could be addressed by using the alternative wording for the second bullet point that we suggest above, and rewording the first bullet point to “preparing or presenting information in a manner that neither misleads nor is intended to mislead”.

The enhanced guidance in the rest of this section is helpful in illustrating the types of appropriate actions and behaviours. However, we identify below how it could be further improved.

*2. In particular, do respondents support the guidance in paragraph 320.3 addressing the issue of misuse of discretion in a manner that is intended to mislead? If not, please explain why. Are there any other considerations relating to this issue that should be addressed in Section 320?*

We believe that the word ‘financial’ should be deleted from the first sentence of paragraph 320.3, because the paragraph should apply equally to non-financial information. We also note the use of the terms ‘judgment’ and ‘discretion’ in that sentence but that their relationship is unclear. We recommend that this sentence should be amended along the following lines: “In making judgments in the course of being involved with the preparation or presentation of the employing organisation’s information, the professional accountant should exercise any discretion it has in doing so in a manner consistent with the principle in paragraph 320.2” (referring to 320.2 revised as suggested above). It may also be helpful to explain the relationship between judgments and discretion<sup>2</sup> in this context.

For consistency with our recommended changes to paragraph 320.2, described above, we recommend that the second sentence of paragraph 320.3 be amended along the following lines: “Accordingly, preparing or presenting such information fairly and honestly requires the professional accountant not to exercise such discretion in a manner that *either misleads or is intended to mislead ...*”, with appropriate conforming changes to the wording of the bullet points.

Most of the illustrative examples of exercising discretion in making judgments in a manner that is intended to mislead use the term “manipulate”. Common usage of “manipulate” does not always signify something that is inappropriate and we believe clearer wording is needed. For example, the first bullet point could be amended to:

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<sup>2</sup> For example: Judgments are decisions as to a course of action or an outcome, made in an informed and considered manner, weighing the evidence and implications of the possible choices to determine which is most ‘appropriate’. What is appropriate may be defined by rules or by reference to a framework or may be within the discretion of the person making the judgment, taking into account all the circumstances.

“... over- or under-accruing warranty expenses in order to intentionally state income at an amount other than the most appropriate amount.”

The second bullet point could be amended to:

“... selection of a method that is not the most appropriate from among alternative revenue recognition methods.”

The third and fourth bullet points – timing of transactions and structuring of transactions – may not be matters that are ‘determined’ **at the time of, and for the purpose of**, preparing and presenting financial information. Also, they may be matters for which the professional accountant has no responsibility, particularly in larger organisations. A sales team may be motivated to push sales as a period end approaches in order to meet targets – this could be regarded as a form of ‘manipulating’ sales but, providing the sales are properly earned in the period, it does not render them invalid. With respect to the preparation and presentation of financial information, the professional accountant’s responsibility is to ensure transactions are recorded in the correct period and that the accounting and presentation properly reflects their structure and effect in accordance with the requirements of the applicable financial reporting framework. This should also include the possible need for supporting disclosures to give users an appropriate understanding of relevant context, such as an artificial push to complete sales early that may result in lower than expected sales in the following period.

*3. Paragraph 320.4 provides guidance as to what PAIBs are expected to do ethically in order to prepare or present fairly and honestly information that does not have to comply with a relevant reporting framework. Is this guidance sufficient? If not, what further guidance could Section 320 usefully provide?*

The guidance in paragraph 320.4 is very limited and is not clearly presented as relating to circumstances where there is not a relevant reporting framework. We believe the factors identified here are of more general application and have suggested above that they should be incorporated into the overarching principle in a revised paragraph 320.2. The remaining guidance needs to clarify that the overarching principle also applies where there is no relevant reporting framework. It should be clear that the professional accountant should ensure sufficient relevant information is given to enable the intended users to have a reasonable understanding of the information that is relevant to their needs, in particular in relation to matters of judgment and estimation and the assumptions underpinning them. The nature and extent of such information may depend on a number of factors, including the context in which the information is presented, including its purpose and who are the intended users; and whether and to what extent there is an applicable financial reporting framework and/or other criteria affecting the information.

*4. Do respondents agree that where a PAIB relies on the work of others, the PAIB should be required to take reasonable steps to be satisfied that such work enables the PAIB to comply with the overarching principle in paragraph 320.2?*

We believe that the term ‘where a PAIB relies’ suggests an active choice by the PAIB and that it would be more appropriate to say “...where the outcome of the professional accountant’s work is dependent on the involvement of others in the preparation or presentation of the information, ...”. It would also be helpful to be clearer as to what are “reasonable steps”. This may depend on the seniority of the professional accountant in the employing organisation and the nature of their role and responsibilities. It may not be reasonable to expect a PAIB to test or check the work of others or to consider work performed by others more distant from them in the chain of involvement in the preparation or

presentation of the information. In practice, what is reasonable will depend on the seniority of the professional accountant and the nature of their role and responsibilities.

For example, in large organisations/groups, the outcome of the professional accountant's work may in practice depend on the work of others, or on the effective operation of internal controls over that work that are the responsibility of others, who may be far removed from them in the chain of involvement in the preparation or presentation of the information. For example, others with significant involvement could be based in a service centre in another part of the world.

In circumstances such as these, for a professional accountant who is relatively junior in the employing organisation, 'reasonable steps' may involve consulting internal manuals and making appropriate inquiries to enable them to consider, in relation to the work of those close to them in the chain of involvement in preparation or presentation, whether such work that is significant to the outcome has been performed in a manner consistent with the principles in this section and whether they are aware of any evidence that it has not been.

For a more senior professional accountant, 'reasonable steps' may include considering the work of others more distant in the chain of involvement, and obtaining an understanding of the outcomes of tests by others of controls over that work (e.g. by internal auditors). However, the professional accountant should not be expected to always undertake such tests themselves.

*5. Do respondents agree with the guidance proposed in paragraphs 320.6 and 320.7 regarding disassociation with misleading information? Are there other actions that could be specified?*

The substance of the requirement in the first sentence of paragraph 320.8 should be integrated with the requirement in the first sentence of paragraph 320.6. It establishes an overarching principle that the professional accountant shall not knowingly be associated with misleading information. However, its formulation is that the professional accountant "should refuse to be or to remain associated" with information if they have determined that it is misleading. Association is a matter of both fact and perception. It may not therefore be possible for a professional accountant to refuse to be or to remain associated with the information.

In addition, the formulation in paragraph 320.6 that the professional accountant shall 'take steps to resolve the matter' is neither sufficiently informative about the actions required, nor does it indicate the desired outcome of such actions. If information is or may be misleading, it may cause harm by undermining the intended use of the information. We believe that the overarching principle in this area should first require action by the professional accountant to seek to prevent that harm – by taking action to have the information corrected before it is used, or to have the matter appropriately brought to the attention of the intended users and other relevant persons (such as those whose involvement with the preparation or presentation of the information may depend on the misleading information). However, it should also, if appropriate (such as when it is not possible to prevent the harm), require action by the professional accountant to seek to disassociate him/herself from the misleading information. We believe that parallel issues were addressed by the IAASB in dealing with misstated 'other information' in revising ISA 720 – see paragraphs 19 and A49 to A50 of the revised standard.

Where a professional accountant has been involved with the preparation or presentation of information, it should be presumed that they are associated with the information. It would be helpful to clarify this. Furthermore, paragraph 320.6 as drafted does not appear to be limited

to information with which the professional accountant is associated through being involved with its preparation or presentation. It would be helpful to amend this to clarify whether this is intentional (though we do not think that is necessary) or not and, if so, to provide some examples of how such association may arise. The requirements and guidance in paragraphs 320.6 and 320.7 start from the premise that the professional accountant has already determined that the information is misleading. In our view, they should also cover circumstances where the professional accountant has identified reasons to believe that the information 'may' be misleading.

We suggest redrafting paragraph 320.6 (combining the first sentence thereof with the principle in the first sentence of paragraph 320.8 and separating these from the remaining guidance in paragraph 320.6) along the following lines:

“Where a professional accountant has determined, or has reason to believe, that the information he/she has been involved with preparing or presenting may be misleading, he/she should seek to have the information corrected, or to have the matter brought to the attention of the intended users of the information and to other relevant persons. These include other people involved with the preparation or presentation of information, the outcome of whose work is dependent on the information that is or may be misleading. If it is not possible to have the information corrected or to have the matter brought to the attention of such persons, the professional accountant shall seek to disassociate him/herself from the information.”

“Steps the professional accountant may take in seeking to have the information that is or may be misleading corrected, or brought to the attention of the intended users of the information and other relevant persons, include:

- consulting the employing organisation’s policies and procedures (for example an ethics policy) regarding how such matters should be addressed internally;
- discussing their concerns that the information is or may be misleading with their supervisor and/or the appropriate level(s) of management within the employing organization, or those charged with governance, and requesting such individuals to take such action as is necessary to determine whether the information is in fact misstated and/or, as appropriate, requesting them:
  - if before the distribution of the information, to correct the information; or
  - if after the distribution of the information, to inform the intended users of the information and other relevant persons about the matter and/or the corrections that need to be made to the information.”

The guidance in paragraphs 320.7 and 320.8 should also address considerations as to whether the professional accountant has reason to believe the information is intentionally misleading. This could affect the steps taken to address the matter, for example with regard to the lines of internal reporting or whether it is necessary to report (or whistle blow) to an external authority. It would also be helpful to provide some guidance to assist the professional accountant in considering resignation – we believe this should be considered in light of the seriousness of the matter and the balance of the public interest benefits weighed against the adverse consequences (a similar test was applied in the new auditor reporting standard ISA 701 for the omission of key audit matters – see paragraph 14(b)).

A key consideration, particularly with respect to misleading information that is reported outside the organisation, is whether there is a responsibility to communicate to a third party. Further, if there is a legal or regulatory responsibility then this is something the professional accountant is required to do, not just consider doing.

Having regard to the above points, we suggest amending and combining paragraphs 320.7 and 320.8 along the following lines:

“If, after taking such steps, the professional accountant determines that corrective action has not been taken and believes that the information still is or may still be misleading and the matter has not been brought to the attention of users and other relevant persons, the professional accountant shall seek to disassociate him/herself from the information. The professional accountant shall determine whether any legal or other requirements exist for him/her to communicate to third parties, including users of the information, regulatory authorities or the employing organization’s external accountant or auditor. In seeking to disassociate him/herself from the information, the professional accountant may consider communicating directly with the intended users and other relevant parties (particularly if they are internal to the employing organisation). The professional accountant shall also consider resigning from the employing organisation, having regard to the seriousness of the matter and whether the public interest benefits of doing so would reasonably be expected to outweigh the adverse consequences of doing so. When determining appropriate actions, the professional accountant may consider consulting with a relevant professional body and/or consulting legal counsel regarding his/her and the employing organisation’s responsibilities.”

## **Proposed Section 370**

### *1. Do respondents agree with the overarching requirements in paragraphs 370.1 and 370.2?*

We agree in principle with the overarching requirements, which we see as ethical principles supporting the fundamental principles. However, the term ‘pressure’ does not distinguish between what may be appropriate and what may not. We would suggest using the term ‘inappropriate or undue pressure’, in which case paragraph 370.3 would be unnecessary. That paragraph is anyway somewhat circular and unhelpful in explaining what we believe is the intended distinction. In addition, paragraph 370.1 could be helpfully shortened and reorganised so that the overarching requirement/principle is emphasised and presented first rather than last, and to limit its scope to the professional accountant him/herself (so that it is clear that it is not intended to require the professional accountant to prevent others, such as those who may report to them, from yielding to such pressure). In paragraph 370.2, the threshold of ‘knows’ that the pressure would result in a breach is too high and arguably can never be reached on such a matter with certainty. We believe a threshold of ‘it would be reasonable to expect or believe that it could result in other persons taking actions that would result in a breach of’ (or in the case of such a person who is not a professional accountant ‘actions that would be inconsistent with’)<sup>3</sup> the fundamental principles would be more appropriate. For example, the requirements could accordingly be amended along the following lines:

“The professional accountant shall not allow inappropriate or undue pressure to result in them breaching the fundamental principles. A professional accountant in business may face pressure that could create threats, for example, intimidation threats, to compliance with the fundamental principles when undertaking a professional activity. Pressure on a professional accountant may be explicit or implicit. Pressure and may come from within the organization (for example, from a colleague or superior), from an external individual or organization such as a vendor, customer or lender, or from

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<sup>3</sup> Arguably a person not subject to the Code cannot be in breach of it.

meeting internal or external targets and expectations. ~~The professional accountant shall not allow such pressure to result in a breach of the fundamental principles.~~" (370.1)

"The professional accountant shall not place inappropriate or undue pressure on others such that it would be reasonable to expect or believe that it could result in those persons taking actions that would breach or be inconsistent with the fundamental principles ~~that the professional accountant knows or has reason to believe would result in a breach of the fundamental principles.~~" (370.2)

"[Delete]" (370.3)

Similar language changes would be needed in the subsequent paragraphs.

*2. Are the illustrative examples of types of pressure that could result in a breach of the fundamental principles in paragraph 370.4 helpful?*

We believe that the list of illustrative examples is unnecessarily detailed and risks supporting a rules based, rather than principles based mindset. Also, some of the potential pressures identified relate to matters that in many jurisdictions would constitute fraud or other illegal acts – it is not helpful to mix ethical considerations with legal considerations. We would expect a professional accountant to be aware when they are under inappropriate or undue pressure, and that in no circumstances should they breach relevant laws and regulations. The guidance in this section should be focussed on the considerations when the professional accountant is being subjected to such pressure.

*3. Is it sufficiently clear that Section 370 addresses pressure that could result in a breach of fundamental principles, as opposed to the routine pressures that exist in the workplace? In particular, does paragraph 370.5 provide sufficient guidance to assist the PAIB in making that distinction? If not, what other considerations should the PAIB take into account?*

The overarching requirement/principle should be that a professional accountant does not allow pressure of any type to result in a breach of the fundamental principles. The guidance in this section is intended to address pressures that are 'unreasonable/inappropriate', rather than 'routine'. This could be stated more explicitly in paragraph 370.3, as suggested above, using the term 'inappropriate or undue pressures'. It is important to recognise that pressures that are ordinarily 'routine', such as to meet a reporting deadline, can become unreasonable (undue) if, for example, the reporting deadline is set too tightly to enable necessary information to be obtained and processed.

*4. Do respondents find the guidance in paragraph 370.6 on responding to pressure that would result in a breach of the fundamental principles helpful? Are there other actions that should be considered?*

The guidance in paragraphs 370.5 and 370.6 are presented as something the professional accountant "may wish" to consider. We appreciate this is guidance rather than a requirement, but it appears very weak and we suggest that the use of "wish" is deleted and that the purpose of considering such matters is addressed (for example, "The professional accountant may consider the following actions in seeking to eliminate, counter or circumvent such pressure:").

The second bullet point of paragraph 370.5 identifies “the corporate culture and leadership of the employing organisation, including the extent to which it emphasizes the importance of ethical behaviour and the expectation that employees will act in an ethical manner” as something the professional accountant may consider when faced with pressure. This is not particularly helpful advice on what to consider once the pressure has already been exerted and therefore seems out of place in this paragraph. However, we do consider that a professional accountant should seek to influence the establishment of an appropriate culture that does not support unreasonable pressure.

Paragraph 370.6 is premised on the condition that ‘the professional accountant has determined that the pressure would result in a breach ...’ – the premise is contrary to the requirement in the last sentence of paragraph 370.1. We do not believe that the distinction between the types of pressure that ‘could’ and ‘would’ result in a breach is likely to be relevant in practice. When faced with inappropriate or undue pressure the professional accountant will need to take actions to seek to eliminate, counter or circumvent that pressure. In either case, it is not acceptable for the professional accountant to succumb to the pressure and take action that would breach the fundamental principles. We would therefore merge paragraphs 370.5 and 370.6, with the introductory text suggested above.

The second bullet point of paragraph 370.6 identifies that an action the professional accountant may consider when faced with pressure is to “Request restructuring or segregation of certain responsibilities and duties so that the professional accountant is no longer involved with the individual or entity exerting the pressure.” This would not address the fundamental problem but rather would impose it on someone else. What should be done is that the individual or entity exerting the pressure be informed that it is behaving unreasonably and requested to cease doing so.

*5. Are the references to other sections of Part C of the Code, in paragraph 370.9, helpful?*

It is helpful to cross refer to other relevant guidance.

## **Other comments**

### ***Considerations relevant to accountants preparing and presenting information that will be audited***

In the conforming amendments to section 300, we recommend that that paragraph 300.6 is further amended to: “A professional accountant in business shall not knowingly engage in any business or occupation or activity that a reasonable and informed third party, weighing all the facts and circumstances at the time, would be likely to conclude impairs or might impair the professional accountant’s integrity or objectivity, or the integrity or objectivity of any other individual responsible for the preparation, approval or audit of the entity’s financial information...”. This would help address situations where, for example, a former auditor has joined the entity and the threat that while his or her objectivity might not be impaired, his or her role may, through intimidation or familiarity threats, impair the objectivity of the audit team (with the attendant risks to the accuracy of the financial statements).

### ***Scope of the IESBA project***

We understand that these proposals are intended to address just issues relating to the involvement of PAIBs in the preparation or presentation of information, including issues relating to pressure from others to engage in unethical or illegal acts; and that phase 2 will address payments and bribes. We suggest IESBA also explores whether more guidance

could help address issues that may involve PAIBs where ethics are less clearly judged. For example, in the UK there is debate about the ethics of involvement in matters such as aggressive contracts with suppliers who may not be in a position to obtain fairer terms, and developing aggressive tax avoidance strategies.

Yours sincerely



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**About the FRC**

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