

Meeting: IESBA CAG

Meeting Location: New York

Meeting Date: September 10-11 2013

Agenda Item

B

Review of Part C of the Code— Pressure to Engage in Unethical or Illegal Acts

Objective of Agenda Item

1. To obtain CAG Representatives' views on a straw man of proposed changes to the *Code of Ethics for Professional Accountants* (the Code) to address the topic of pressure to engage in unethical or illegal acts and related issues.

Project Status and Timeline

2. At its meeting in March 2013, the IESBA approved the project to review Part C of the Code, including that priority attention be given to the following topic areas:
 - Pressure by superiors and others to engage in unethical or illegal acts (Pressure);
 - The responsibility of professional accountants in business (PAIBs) to produce financial reports that are faithful representations of the economics of transactions, and associated matters (Faithful Representation); and
 - Facilitation payments and bribes (Inducements).
3. At its meeting in April 2013, the CAG considered the project proposal.
4. At its June 2013 meeting, the IESBA considered issues related to the scope of Part C, specifically how Part C may be relevant to professional accountants in public practice (PAPPs). The IESBA agreed to defer further consideration of this matter until after the topics of Pressure, Faithful Representation and Inducements, as these relate specifically to professional accountants in business (PAIBs), have been addressed.
5. This project is divided into two phases:
 - Phase I will review Sections 300,¹ 320,² 330³ and 340⁴ of the Code and will, in particular, address the topics of Pressure and Faithful Representation.
 - Phase II will address Section 350,⁵ which is related to the topic of Inducements.

¹ Section 300, *Introduction*

² Section 320, *Preparation and Reporting of Information*

³ Section 330, *Acting with Sufficient Expertise*

⁴ Section 340, *Financial Interests*

6. The Task Force will be aiming to present a first read of an exposure draft for Phase 1 at the April 2014 IESBA meeting.

April 2013 CAG Discussion

7. Below are extracts from the draft minutes of the April 2013 CAG meeting,⁶ and an indication of how the project Task Force or IESBA has responded to CAG Representatives' comments.

Representatives' Comments	Task Force Response
Mr. Morris agreed that Parts A and C should not be merged. He was of the view that it would be important to keep Part C separate, otherwise the material in the Code of particular relevance to PAIBs will not be obvious to them.	Point accepted.
Mr. Grund noted the reference to this issue in the agenda material for both this topic and the Structure of the Code initiative and wondered about the relationship between the two.	<p>The Task Force was proposing to merge Parts A and C, a structural matter that would have implications for the work of the Structure of the Code initiative, hence the reference to this matter in both sets of agenda papers.</p> <p>The Task Force notes that based on the IESBA discussion in March 2013, it appears unlikely that the IESBA would support merging Parts A and C.</p>
Mr. Koktvedgaard suggested that if there are aspects of Part C which apply to all professional accountants, these should be included in Part A. Mr. Fleck agreed, noting the importance of making sure that the overarching concepts in Part A are also reflected in Part C. Mr. Gaa noted that Part C applies to professional accountants in public practice in their capacity as employees and that the Task Force intends to consider the matter.	Point noted. As indicated in the Project Status and Timeline section above, the IESBA is prioritizing consideration of matters specific to PAIBs. The Task Force and IESBA will further consider the applicability of Part C to all professional accountants in due course.
Ms. Blomme noted the significant discussion on earnings management at the previous CAG meeting and the general sense that this should not be a focus of the project. Mr. Gaa noted his view	Point noted. The Task Force is currently focusing on the priority topics noted above.

⁵ Section 350, *Inducements*

⁶ The minutes will be approved at the September 2013 IESBA CAG meeting.

that earnings that do not breach laws or regulations can be misleading, and therefore there would be merit for a discussion. However, he agreed that there may not need to be bright lines in the Code regarding what would or would not be acceptable.	
Ms. Blomme expressed support for the link to accounting standard setters in the project proposal.	Support Noted
Mr. Diomeda wondered about the connection between the legal responsibilities of the entity and the ethical responsibilities of the PAIB. He felt that the former would have a greater responsibility than the latter. He also questioned what matter the Task Force was addressing in seeking a more positive and fuller statement of the responsibility of the PAIB.	Mr. Gaa responded that it is actually the PAIB who prepares the financial information. He noted that one of the difficulties is that companies can manipulate financial statements without breaching financial reporting standards. Accordingly, there is a difference between entities' legal responsibilities and PAIBs' ethical responsibilities with respect to their organizations. Mr. Gaa also noted that the Code provides statements about what a PAIB should avoid and he would like the Code to make a positive statement about the PAIB's responsibilities.

Matters for CAG Consideration

A. One Section (340) vs. Two Sections (340 and 3x0)

8. Following the June 2013 Board meeting, the Task Force (TF) considered the merits of having one section on Pressure as originally contemplated in the project proposal or having an additional section on Pressure. For the reasons articulated below, the TF is proposing that Section 340 be retained and a new Section 3x0 be developed, an approach which had been suggested by some IESBA members at the June 2013 Board meeting.
9. Section 340 addresses circumstances that may create self-interest, familiarity and self-review threats to act unethically due to the motive of *personal* (financial) gain. It is limited and does not address other forms of pressure and motives other than financial gain. It therefore does not provide sufficient guidance for the PAIB facing pressure.
10. From a practical standpoint, an additional section would minimize the changes to section 340, which has been recently revised as a result of the Conflicts of Interest project but which is not yet effective.
11. Section 340 focuses on a critically important ethical issue, i.e., that the potential for financial gains of the PAIB and/or financial gains of others may create a threat to complying with the fundamental principles. The TF proposes that Section 340 remain focused on a specific major problem in accounting.

12. The TF proposes that Section 3x0 apply to all situations in which pressure from a *superior or colleague (or other party)* to engage in an unethical or illegal act threatens compliance with the fundamental principles. This includes situations specifically addressed by other sections of Part C in which pressure is an additional factor. The TF believes this is the simplest and most straightforward way of producing a section that focuses on pressure of all kinds from others, which was the major issue identified in the Part C Working Group's surveys that ultimately led to the project proposal. In addition, this new section would fit with the other sections in Part C, in that it would provide guidance on all kinds of situations, including:
- Undertaking a professional activity for two parties whose interests are in conflict and one or both parties are pressuring the PAIB to act in their best interest (pressure not explicitly addressed in Section 310).⁷
 - Situations in which a PAIB is pressured to engage in unethical or illegal reporting (not related to financial gain of that other person, e.g., because it might be "good" for the business (pressure mentioned in 320).
 - Situations in which a PAIB is pressured by superiors to perform a task without sufficient skills or training or without sufficient time (pressure not explicitly mentioned in Section 330).
 - Situations in which the PAIB might be pressured by a superior or colleague to manipulate reports for their financial gain (pressure mentioned in Section 340),
 - Situations in which the PAIB may be pressured to participate in a bribe (pressure mentioned in Section 350).
13. As indicated, other sections in Part C recognize the possible existence of pressure as an additional factor in the situations addressed in those other sections. However, they do not deal with the pressure in a substantive way. A separate section (3x0) on pressure recognizes that in situations that are addressed in the other sections, pressure may be an additional factor. The Code would then provide guidance to address the ethical matters specific to Sections 310, 320, 330, 340, and 350, and guidance in the new Section 3x0 to address the Pressure.
14. The TF is of the view that rewriting Section 340 to address pressures of all kinds as well as the special case of personal gain relating to reporting would be difficult and complex, and might produce a standard that would be very difficult to follow.
15. The TF believes that a new Section 3x0 would enable more detailed guidance to be provided in a clearer way, including a process to follow, relating to Pressure specifically, compared with one section dealing with Pressure and financial interests, compensation and incentives linked to financial reporting and decision making.

Structure of Two Sections

16. If there are to be two sections, it is necessary to decide how the new Section 3x0 would fit with the recently amended Section 340, the references to pressure in the superseded version of Section

⁷ Section 310, *Conflicts of Interest*

310 (as a result of the Conflicts of Interest project), the yet to be revised Section 320 and Section 350. Doing so will ensure that the wide range of pressures faced by PAIBs is captured while avoiding sections overlapping.

17. The TF analyzed references to Pressure in Part C using the conceptual framework in order to align pressures to be addressed in Section 3x0 with pressure in other sections in Part C. The Conceptual Framework states that “when a relationship or circumstance creates a threat, such a threat could compromise...compliance with the fundamental principles”. To fit the conceptual framework, “pressure” is the circumstance that creates the threat. Pressure itself is not the threat. Part C, as recently revised, includes the following references to Pressure.

	Circumstance	Threat	Compromise
Section 320 (Preparation and reporting of information)	Pressure	Intimidation	To become associated with misleading information
Section 320	Personal Gain	Self Interest	To become associated with misleading information
Section 340 (Financial Interests, Compensation and Incentives to Linked Financial Reporting and Decision Making)	Financial Interests	Self Interest or self-interest of others	To manipulate price sensitive information
Section 340	Pressure	Intimidation	To manipulate information
Section 350 (Inducements)	Pressure	Intimidation	To offer inducements

18. In addition, extant Section 310 contains the following references to pressure that will soon be superseded as a result of the revision to Section 310 under the Conflicts of Interest project:

	Circumstance	Threat	Compromise
Section 310 (Potential Conflicts)	Pressure	Intimidation	To act contrary to law or professional standards, facilitate unethical earnings management strategies, become associated with

			misleading reports,
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19. The Task Force examined a number of ways to differentiate matters addressed in Section 340 from a new Section 3x0. The Task Force considered using the type of threat to differentiate the Sections but agreed that the Code does not generally allocate a particular “relationship or circumstance” to a particular type of threat. Section 340 is focused on financial interests and financial gain and the Task Force considered whether Section 3x0 could address non-financial pressures, but agreed that although non-financial pressures exist, non-financial pressures would not capture all circumstances.
20. Accordingly, the Task Force proposes to leave, or revise, Section 340 to address all personal financial gain relating to financial reporting, and to address in a new Section 3x0 all pressures from others (including pressures to achieve financial results). The Task Force will also determine whether it would be appropriate to move any of the existing guidance from the Sections listed in the table above to Section 3x0 to avoid duplication of guidance.
21. The straw man wording has been developed with the “two-section” approach.

Matter for CAG Consideration

1. Do Representatives agree that Pressure should be addressed as a new Section 3x0 in addition to Section 340, rather than replacing it?

B. Straw Man Text of Section 3x0

22. The TF developed the straw man wording in Agenda Paper B-1 for a new Section 3x0 based on the following five-part structure, which is supported by the Board:
 1. Description of pressure and linkage to fundamental principle(s)
 2. Examples of pressure
 3. Identification of threats to compliance
 4. Evaluation of threats
 5. Application of safeguards

Description of Pressure to Engage in Unethical or Illegal Acts

23. The draft guidance is focused on “pressure to engage in unethical or illegal activities” rather than “undue or inappropriate pressure.” This is preferred because the former is less subjective and does not result in having to define what would be considered “undue” or “inappropriate.” Secondly undue pressure may include imposing an unreasonable workload on subordinates, which might not be an ethical matter to be included in the Code.
24. The draft guidance addresses “pressure to engage in unethical or illegal activities”. Illegal activities are objective in the sense that a legal standard exists for judging possible illegality. The straw man uses wording from Suspected Illegal Acts straw man to describe what is illegal.

25. Judging whether an activity is unethical is subjective because of the lack of such a standard. The Code does not define “unethical activities”. The TF proposes that “An unethical activity is one that breaches any of the fundamental principles contained in Part A of the Code and the interpretative guidance contained in Part C.”
26. The project proposal stated that the Task Force would address pressure to act inappropriately by those in a superior position and also the issue of a PAIB placing pressure on others. The latter does not appear to be a matter for a threats and safeguards/guidance approach because there should be no circumstances in which it is acceptable to exert pressure to engage in unethical or illegal activities. Because this would be a requirement it is dealt with once in the Section while the remainder of the Section provides guidance on dealing with pressure being placed on the PAIB.
27. The TF considered whether, assuming downward pressure is prohibited in Section 3x0, any safeguard could be included in respect of the downward pressure. The TF noted that the Code prescribes safeguards only to eliminate threats or reduce them to an acceptable level. Requirements and prohibitions are used in the Code where safeguards are not available to address the threats. The TF also noted that paragraph 300.5 states that:

A professional accountant in business may hold a senior position within an organization. The more senior the position, the greater will be the ability and opportunity to influence events, practices and attitudes. A professional accountant in business is expected, therefore, to encourage an ethics-based culture in an employing organization that emphasizes the importance that senior management places on ethical behavior,
28. The Task Force is considering the implications of this paragraph in relation to whether PAIBs in senior positions may have a responsibility to make their best efforts to ensure that the employing organization has mechanisms (such as internal controls) in place in order to eliminate pressures that may exist in the organization as a whole to engage in unethical or illegal activities, or to reduce the threats caused by such pressure to an acceptable level.

Matters for CAG Consideration

2. Do Representatives agree that the guidance should address “unethical and illegal activities” rather than “undue or inappropriate pressure”?
3. Do Representatives agree with how the TF has described unethical and illegal activities?

Examples of Pressure

29. The TF intends the list of examples to be practical and include a variety of situations that PAIBs will recognize. Because the definition of PAIB is broad and includes, for example, professional accountants in the public sector, the TF proposes to include an example for professional accountants in the public sector, and examples that will resonate with professional accountants working in SMEs.

Identification of Threats to Compliance

30. The Conceptual Framework states that “when a relationship or circumstance creates a threat, such a threat could compromise...compliance with the fundamental principles”. To fit the conceptual framework, “pressure” is the circumstance that creates the threat. Pressure itself is not the threat. Having provided examples of pressure, the TF has elaborated on the types of threats that a PAIB may face, in order to help the PAIB identify the threat before evaluating it, in the next paragraph.
31. The TF examined each of the five threats in paragraph 100.12. The TF is of the view that pressure is a “push” motive and is different from the self-interest “pull” motives in Section 340. Therefore the types of threats that pressure creates are most likely to be intimidation, and possibly familiarity. In this regard, the Task Force proposes four examples of threats that it believes are typically faced by a PAIB.
32. Paragraph 310.3 (Conflicts of Interest) includes the reasonable and informed third party test when identifying and evaluating whether a Conflicts of Interest exists or could compromise compliance with the principles. The TF does not believe this works for purposes of identifying and evaluating threats created by pressure. For example, does it make sense to state that the PAIB should “...be alert to all pressures that a reasonable and informed third party...would be likely to conclude might result in unethical or illegal activities” or rather, “...might compromise compliance with the fundamental principles”? While one could argue it might be appropriate to consider the views of a reasonable and informed third party in considering whether an activity is unethical, it does not appear to make sense with respect to an illegal activity. The TF discussed this issue and tentatively concluded that the reasonable and informed third party concept does not work with the issue of pressure.
33. A PAIB may be employed by an organization, and over time adopt the cultural norms of the organization. The TF proposes to make reference to this to alert the PAIB to this risk.

Evaluation of Threats

34. The TF noted that PAIBs will always be faced with pressure. Because it is subjective, the concept of “unreasonable or undue pressure” is unworkable for inclusion in a standard on pressure. A number of examples were cited where pressure was needed to achieve an objective, which was reasonable in the perception of the organization or manager but potentially unreasonable in the perception of the individual. The conceptual framework avoids this difficulty by evaluating the threat and not evaluating the pressure. The threat is identified at the identification stage. The TF proposes guidance to the PAIB by providing examples of factors that will determine whether the threat is significant.
35. The TF is aware that culture can play a role in evaluating threats caused by pressure. Some industries and some jurisdictions are more aggressively competitive than others. The TF is considering making reference to this to alert the PAIB to recognize that the environment in which the PAIB works may affect the chance that the PAIB faces pressure to engage in unethical or illegal acts (see paragraph 10 of the straw man). However, because illegal and unethical acts are not acceptable in any environment, the TF plans to consider this further because it could be read to allow activities that are accepted in a given industry where unethical practices are common.

36. Unlike Public Practice, the PAIB may not be surrounded by colleagues who are also subject to the Code's ethical values. Therefore, it may be difficult to obtain the advice of a suitable third party who may assist in evaluating the threat. Depending on the organization, seeking guidance from within the employing organization may be appropriate. In other circumstances going outside the organization may be appropriate. The TF proposes to use wording from elsewhere in the Code to provide a list of possible suitable third parties.

Matter for CAG Consideration

4. Is it appropriate to acknowledge, in the Code, the diversity of ethical norms between organizations, industries and countries in order to alert PAIBs to the threats that such circumstances exist?

Application of Safeguards

37. The TF believes that because this Section is intended to provide additional guidance to PAIBs in responding to pressure, the paragraph on safeguards is potentially the most important paragraph in this Section. Therefore it provides an extensive list of possible safeguards.
38. Some IESBA CAG representatives reminded the TF to include the public sector in its review of Part C. The TF is of the opinion that in many cases the pressures faced by PAIBs are similar in the public and private sectors; however it looked for any safeguards that may be specifically relevant to the public sector. Those identified to date include (disclosing the matter to) a government ombudsman, government agencies, anti-corruption commission, or auditors general.
39. In many organizations the PAIB is the only professional staff member and may be isolated and have few available safeguards. The TF agrees that consulting with an appropriate person is an important safeguard but recognizes the risk of inadvertently breaching confidentiality when consulting with third parties, even on an anonymous basis.

Material Presented – CAG Paper

Agenda Item B-1 Pressure to Engage in Unethical or Illegal Acts—Straw Man