

**Meeting:** IESBA CAG

**Meeting Location:** New York

**Meeting Date:** September 14, 2016

## Agenda Item

# D

### Review of Part C of the Code—Phase 2

#### Objectives of Agenda Item

1. To obtain CAG Representatives' views on Task Force proposals regarding:
  - (a) The addition of an explanatory paragraph in the restructured Code to highlight the applicability of extant Part C to professional accountants in public practice (PAPPs).
  - (b) Revisions to extant Section 350<sup>1</sup> of the Code addressing inducements.

#### 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), and the applicability of Part C to PAPPs.
3. This project is divided into two phases:
  - Phase 1 addressing Sections 300,<sup>2</sup> 310,<sup>3</sup> 320,<sup>4</sup> 330<sup>5</sup> and 340<sup>6</sup> of the Code and, in particular, the topics of Pressure and Faithful Representation.
  - Phase 2 addressing Section 350, which is related to the topic of Inducements, and the applicability of Part C to PAPPs.

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<sup>1</sup> Section 350, *Inducements*

<sup>2</sup> Section 300, *Introduction*

<sup>3</sup> Section 310, *Conflicts of Interest*

<sup>4</sup> Section 320, *Preparation and Reporting of Information*

<sup>5</sup> Section 330, *Acting with Sufficient Expertise*

<sup>6</sup> Section 340, *Financial Interests*

4. Phase 1 was completed in December 2015 with the approval of revised Section 320<sup>7</sup> and new Section 370<sup>8</sup> and related conforming amendments to other sections of Part C (“close-off document”) under the current structure and drafting conventions.
5. The close-off document is currently being restructured under the new structure and drafting conventions for the Code. The restructured text will be included in the second Structure of the Code exposure draft anticipated for approval by Q4 2016.
6. Appendix 2 provides the project history for Phase 2.

#### Report Back on March 2016 CAG Discussion

7. Below are extracts from the draft minutes of the March 2016 CAG meeting<sup>9</sup> and an indication of how the project Task Force and/or IESBA has responded to the CAG’s comments.

Matters Raised	Task Force/IESBA Response
CLOSE-OFF DOCUMENT	
Mr. Hansen asked a general question about the purpose of a close-off document.	Mr. Siong explained that a close-off document indicates that the IESBA has concluded its deliberations on all substantive issues in a project under the extant drafting conventions. Absent the Structure of the Code project, the Part C close-off document would have been released as a final pronouncement after the PIOB has approved due process. However, there is a need to restructure the close-off document in the new Structure format before it is released. Mr. Gunn added that this approach is consistent with the approach that the IAASB used when clarifying its ISAs.

#### I. Part C, Phase 2 Project History

8. The Part C project proposal highlighted some issues that the Task Force should consider under Phase 2 of the project:
  - Whether additional guidance is needed to assist the PAIB when encountering the making of offers of inducements and how this might overlap with Section 360,<sup>10</sup> especially as it relates to bribery, corruption and facilitation payments.

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<sup>7</sup> Revised Section 320, *Preparation and Presentation of Information*

<sup>8</sup> Section 370, *Pressure to Breach the Fundamental Principles*

<sup>9</sup> The draft March 2016 minutes will be approved at the September 2016 IESBA CAG meeting.

<sup>10</sup> Section 360, *Responding to Non-Compliance with Laws and Regulations*

- Whether additional guidance that acknowledges the diversity of cultures would be helpful to PAIBs working across different cultures and jurisdictions.
- Whether proposed changes to Section 350 will require conforming changes to Section 260,<sup>11</sup> as PAIBs and PAPPs would be expected to abide by the same ethical standards.

#### APPLICABILITY OF PART C TO PAPPs

##### *Recap of IESBA Discussions*

9. As part of Phase 2 of the project, the Task Force considered whether certain provisions in Part C should explicitly apply to PAPPs and presented its recommendations, including proposed wording to the IESBA.
10. At its March 2016 meeting, the IESBA agreed with the Task Force's view that PAPPs might come across the same issues and ethical dilemmas as PAIBs, such as intra-firm conflicts or situations involving external parties that are not clients. The IESBA also supported the Task Force's proposal that an "explanatory paragraph" be added in the Code regarding consideration of Part C when PAPPs face an ethical dilemma. In this regard, the IESBA agreed with the Task Force that PAPPs should consider the context within which an ethical issue has occurred and then apply the relevant guidance in Part C, irrespective of the specific part of the Code where the guidance is positioned. The IESBA considered and generally agreed with the Task Force's proposed wording for inclusion in the Code to clarify this matter, but asked for some refinements. The latest version of the wording will be considered at the September 2016 IESBA meeting (see Task Force's recommendation below).

##### *Feedback on Structure ED-1*

11. In developing those refinements, the Task Force considered input from some respondents to the December 2015 Exposure Draft, *Improving the Structure of the Code of Ethics for Professional Accountants – Phase 1* (Structure ED-1) relevant to this topic.<sup>12</sup> One of those respondents suggested that the IESBA consider repositioning the following sentence that was presented in paragraph 4 of the Guide to the proposed restructured Code to the body of the Code itself to ensure it is not overlooked:

Professional accountants in public practice might also find [extant] Part C [i.e., restructured Part B] relevant to their particular circumstances.

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<sup>11</sup> Section 260, *Gifts and Hospitality*

<sup>12</sup> The IESBA did not deal with issues related to the applicability of Part C to PAPPs in its Structure ED-1. However, the following proposals are relevant to the issue:

- The sentence in paragraph 100.3 ("Professional accountants in public practice may also find Part C relevant to their particular circumstances") of the extant Code has been repositioned to the Guide;
- The Explanatory Memorandum to ED-1 noted that the order of Parts B and C of the extant Code would be reversed, with "Part C" retitled to be proposed "Part B".

At its March 2016 meeting, the IESBA agreed with the Task Force's plan to liaise with the Structure Task Force before finalizing its proposals and take into account the feedback from respondents to Structure ED-1.

*Task Force's Recommendation*

12. The Task Force agrees with the respondent's recommendation and is of the view that it achieves the same objective as the recommendation set out in the June 2016 IESBA agenda materials, namely that the "explanatory paragraph" should be appropriately located within the restructured Code to ensure that it is not overlooked by users. Accordingly, the Task Force is proposing that the paragraph below be included in restructured Parts 1 and 3, proposed Sections 120<sup>13</sup> and 300<sup>14</sup> respectively:

When facing an ethical issue, a professional accountant in public practice shall consider the context within which the issue has occurred. Where the accountant is performing professional activities pursuant to the accountant's employment or ownership relationship with the firm, there might be guidance in Part 2 that is applicable to those circumstances. If so, the accountant shall comply with relevant provisions. For example, where a PAPP faces pressure from an engagement partner to perform a task without sufficient skills or training or with unrealistic deadlines, the guidance in Section [xxx] would be relevant.

13. Also, the Task Force is of the view that this matter can be subsumed into the Structure of the Code work stream. Accordingly, it will recommend to the IESBA that the Structure of the Code Task Force take the matter forward.

**Matter for Consideration**

1. Representatives are asked for views on the Task Force's recommendations regarding the addition of the proposed "explanatory paragraph" into the restructured Code.

SECTION 350, INDUCEMENTS

14. The Task Force began work on Section 350 at its November 2014 meeting, where representatives of Transparency International UK (TI) were invited to present on the nature of TI's work. The TI representatives also gave a similar presentation at the January 2015 IESBA meeting. In addition, the Task Force reviewed literature and guidance from other organizations regarding the offering and accepting of inducements to ascertain how these organizations had approached the topic.
15. The Task Force then reviewed the extant wording of Section 350 and considered where enhancements might be needed. An agenda paper was presented at the January 2015 IESBA meeting proposing various revisions to Section 350. IESBA views to these proposals included the following:
- The scope of Section 350 needs to be more clearly defined. In this regard, consideration should be given to a GAP analysis to identify areas where improvements could be made.
  - Given the plethora and complexity of rules and regulations relating to bribery and corruption, it would not be advisable to seek to develop guidance on how to follow these rules or how to address each one of them individually. Instead, the Code should emphasize the need to

<sup>13</sup> Proposed Section 120, *The Conceptual Framework*

<sup>14</sup> Proposed Section 300, *Professional Accountants in Public Practice*

understand and abide by applicable laws and regulations and guide the PAIB on how best to act ethically in the circumstances.

16. The Task Force presented the requested GAP analysis to the Board at its April 2015 meeting. Subsequently, work on Phase 2 was deferred pending completion of Phase 1 of the project.
17. The Task Force refocused on Phase 2 at its May 2016 meeting where, based on Board feedback on the GAP analysis, the Task Force considered enhancements that could be made to Section 350. The Task Force's proposals, including a proposed Strawman, were presented at the IESBA meeting in June 2016. See Agenda Paper D-1.

## II. **Part C, Phase 2 Issues**

18. Feedback received at the June 2016 IESBA meeting was considered at the Task Force's meeting in August 2016 with amendments made to the Strawman (see Appendix 1). Views expressed along with the Task Force's deliberation of these are detailed below:

### *Exclusion of Bribery and Corruption*

19. Some IESBA members echoed a view expressed by a few representatives of national standards setters (NSS) at the June 2016 IESBA-NSS meeting, that bribery and corruption should not be excluded from the revised section. Similarly, an IESBA member also noted that bribery and corruption are topical issues and hence stakeholders would expect Section 350 to address them, especially for situations where legislation addressing them does not exist or is not adequate. The Task Force is of the view that the proposed Strawman was not intended to exclude bribery and corruption. It believes that a revised principles-based section should be written to consider all types of inducements (including bribery, corruption, facilitation payments, political lobbying and commission payments) that are not illegal. This fact should be made prominent in a revised Section 350.

### *Laws and Regulations on Bribery and Corruption*

20. Some IESBA members felt that simply directing a professional accountant (PA) to legislation on bribery and corruption might leave a gap in revised Section 350 when legislation does not cover the inducement or is weak. Hence, the PAIB may require supporting ethical guidance.
21. The Task Force considered:
  - Whether definitions of bribery and corruption were needed in order for a PA to conclude whether it was illegal and hence covered by legislation. It concluded that, given the range of different types of bribery and corruption, it would be difficult to devise precise definitions that apply globally.
  - That the occasions when a PA faces an inducement that is not illegal but clearly a bribe would be included in the revised Section 350 by an overarching requirement that a PA shall not give or receive an inducement that is made with the intention of improperly influencing another individual or entity.

### **Matter for Consideration**

2. Representatives are asked for views on:

- (a) The suggestions received on how a revised Section 350 should address bribery and corruption; and
- (b) The Task Force's responses.

#### STRUCTURE OF REVISED SECTION 350

22. An IESBA member suggested that it would be better to structure the revised Section 350 by firstly addressing compliance with the law, then how unethical inducements should be addressed and finally more standard gifts and hospitality. Revised provisions should not be detailed and kept at a high level. The Task Force agrees that a structure that first addresses illegal inducements, such as bribery and corruption before addressing unethical inducements would be suitable.

#### CONTENT OF REVISED SECTION

##### *Revised Title / Scope*

23. IESBA members felt the current title of Section 350, "Inducements," is not ideal and expressed the following views:
- It does not translate well;
  - Is unlikely to be the most common search term;
  - Has a negative connotation; and
  - Does not have a definition and is not easily definable.
24. However, some IESBA members believed that the title of "Gifts and Hospitality," proposed in the initial Strawman, could narrow the scope of the revised section. An IESBA member suggested that a revised title could contain a description to address this concern. Another IESBA member felt that it would be preferable to define the scope of a revised Section 350 first and then allow the title to flow from this.
25. The Task Force agrees that an inducement could be unacceptable (resulting in a breach of the fundamental principles) or acceptable. Hence, the term "inducements" should be considered neutral. Based on this and the views received, the Task Force has amended the title in the Strawman to "Gifts, Hospitality and Other Inducements." To complement the revised title, the Task Force has also added guidance acknowledging that certain types of inducements are not intended to induce unethical behavior.
26. The Task Force also considered that including a requirement relating to a close or immediate family member offering or accepting an inducement would be inappropriate, as the Code is not applicable to, or enforceable on, non-PAs. However, if a PA became aware of a close or immediate family member offering or accepting an inducement, the PA should be required to evaluate any threats to the PA's compliance with the fundamental principles that might arise.

##### *Requirements*

27. IESBA members suggested the addition of the following requirements:

- The PA is prohibited from offering an inducement with the intention of gaining an advantage and encouraging others to do so.
  - The PA is prohibited from accepting an inducement when it is clear that the motivation behind the inducement is unethical.
  - If the threat associated with an inducement cannot be reduced to an acceptable level, the inducement must be declined.
  - The PA is prohibited from receiving or making an illegal inducement.
28. The Task Force agrees that revised Section 350 should contain the first three requirements. As relates to the last suggestion, the Task Force believes that a requirement concerning illegal acts should be drafted in accordance with the NOCLAR standard, but with a focus on laws and regulations governing bribery and corruption. Therefore, the Task Force suggests that the revised Section 350 should contain a reminder that a PA has a responsibility to obtain an understanding of these provisions within their jurisdiction and comply with them.

**Matter for Consideration**

3. Representatives are asked for their views on the proposed requirements and related Task Force proposals.

*Intent Behind an Inducement*

29. An IESBA member suggested that the revised Section 350 should consider the intention, or perceived intention, behind the inducement and whether the actual or perceived intention was to gain an advantage that would not have been otherwise received. It was suggested that consideration of the intent should appear early in Section 350 and before identification and evaluation of threats are addressed.
30. The Task Force agrees that consideration of the intent is vital and therefore should be the starting point for the revised section. It is also of the view that the reasonable and informed third party test could be used to evaluate the perception issue behind the receiving or offering of the inducement. In addition, the Task Force believes that if an inducement is trivial and inconsequential, it could not improperly influence the behavior of the recipient and hence create no threat to compliance with the fundamental principles.

*Fundamental Principles*

31. Some IESBA members believed that there is a need to link provisions addressing inappropriate inducements to adherence with the fundamental principles, notably the fundamental principles of integrity and objectivity. The Task Force agrees and has maintained reference to the fundamental principles in the Strawman.

### *Cultural Differences*

32. IESBA members expressed the following views:

- The revised section should consider cultural discrepancies but not account for every cultural difference. The Task Force agrees that, while cultural differences exist, it would not be practical to account for every cultural difference. While what is an acceptable inducement can vary by culture, the ethical concerns would be the same. Hence, a principles-based Code, following a threats and safeguards approach, should be able to provide suitable guidance that transcends cultures. In addition, use of the reasonable and informed third party test in assessing the perceived intent would involve consideration of the culture in assessing whether to accept the inducement.
- Refusing of a gift can cause offense and damage relationships in some cultures. Hence, consideration should be given to whether guidance is needed in these circumstances, such as referral to local standards or reliance on local regulators or member bodies for guidance.

The Task Force is of the view that local standards would be difficult to define and local practices should not form the basis for a global Code. Similarly, guidance from member bodies should be in conformity with the Code and if local regulatory requirements prohibit an inducement, then it is not permitted.

The Task Force acknowledges that views on what constitutes an acceptable inducement can differ between different cultures. If the value or nature of an inducement is beyond what is generally acceptable for the recipient but there is no misguided intention involved from the giver, receiving the gift should not be considered as a breach of the fundamental principles. Rather, threats should be evaluated and safeguards applied where necessary. If refusal might be considered impolite, the PA should consider safeguards, such as donating the gift to charity. If safeguards cannot reduce the threat to an acceptable level, the inducement must be declined regardless of the ramifications.

33. The Task Force also believes that it would not be appropriate to address cultural issues within the Strawman, but noted that when drafting the revised section:

- Care is needed not to imply that certain cultures are permitted to have a lower standard than others.
- Cultural interpretations of the same inducement would need to be considered, especially when devising a definition of bribery and corruption or examples of inducements. Hence, care should be taken to ensure cultural differences are not used as a cover for unethical inducements.

#### **Matter for Consideration**

4. Representatives are asked for their views on whether and, if so, how cultural differences should be addressed in the revised Section 350.

### *Examples of Inducements*

34. A few IESBA members felt that only a few broad based and high level examples are needed in revised text. The Task Force is of the view that examples are definitely needed within the revised section in



order to assist in establishing what might constitute an inducement. A variety of examples is also important in order to raise awareness of different situations which, depending on the PA's action, might lead to unethical behavior or even illegal acts. The Task Force also noted that documentation published by other organizations relating to inducements contains a number of examples, including some that are specific in nature.

**Matter for Consideration**

5. Representatives are asked for their views on the need to have examples within the revised Section 350 and the nature of these examples.

*Conforming Changes to Section 260*

35. IESBA members that expressed views agreed with the Task Force's recommendation that conforming changes to Section 260 should be considered once revisions to Section 350 are finalized.

*References to other Parts of the Code*

36. The Task Force considers that guidance in Sections 360 and 370 should be referenced in Section 350 as those sections might be relevant to these issues.

**Matters for Consideration**

6. Representatives are asked for any other views or suggestions on matters that should be addressed in a revision of Section 350.

**Material Presented – CAG Reference Paper**

Agenda Item D-1          June 2016 IESBA Agenda Paper

## Appendix 1

### **Revised Strawman Review of Part C of the Code – Phase 2 Section 350, Inducements<sup>15</sup>**

#### Section 350, Gift, Hospitality and Other Inducements

##### **Introduction**

1. This section sets out requirements and provides guidance to PAs on how to address the offering and accepting of gifts, hospitality and other inducements by the PA, or close or immediate family, while respecting the fundamental principles.
2. Bribery and corruption are significant problems in many jurisdictions and carry major public interest issues. Bribery and corruption are unacceptable behaviors for all PAs, regardless of their level of seniority.
3. In most jurisdictions, there are legal or regulatory provisions governing these actions, The PA has a responsibility to obtain an understanding of those provisions and comply with them.
4. A PA may also, in the course of carrying out professional activities, encounter or be made aware of non-compliance or suspected non-compliance with laws and regulations by other individuals working for or under the employing organization. In such situations Section 360 is also relevant.

##### **Requirements and Application Material**

5. A PA shall apply the conceptual framework set out in Section 120 and shall not allow an inducement to compromise compliance with the fundamental principles of integrity and objectivity.

##### *Types of Inducements*

6. There is a broad spectrum of areas that could be considered inducements. Inducements can appear in many different forms, for example: gifts, hospitality, entertainment, facilitation payments and political donations. They can also occur in many different situations, ranging from minor gifts between individuals to major deals between private entities and governments. An inducement can also refer to preferential treatment and inappropriate appeals to friendship and loyalty.
7. Some forms of inducements could be illegal, such as bribery. Others might not be defined as illegal but could still be unethical and result in a breach of the fundamental principles.

##### *Policies and Procedures*

8. While guidance in Section 350 is written using a principles-based approach, to account for jurisdictional and cultural differences, PAs are encouraged to supplement the guidance in this section with more specific policies and procedures from within their employing organizations.

##### *Assessing Intent*

9. Inducements may, to a greater or lesser extent, and depending on the specific situations, be used in ways that affect the PA's ability to act ethically and maintain his or her integrity and objectivity. As a

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<sup>15</sup> All paragraph and section references within this agenda paper are to extant guidance, unless otherwise stated.

starting point a PA shall therefore always assess whether the offering or accepting of the inducement is made with the intention of improperly influencing the behavior of the recipient. The same applies when an immediate or close family member is accepting or is offering an inducement.

10. Where the PA is unable to establish the intent behind the inducement, the PA shall consider additional steps, for example further discussion with the party making the offer.
11. A PA shall not offer or accept any gifts, hospitality or other inducements that are made with the intention of improperly influencing another individual or entity. A PA also shall not misuse entrusted power for private gain.
12. Even when the PA determines that the offering or accepting of an inducement is not made with the intention of improperly influencing the behavior of the recipient, the PA shall consider how the inducement may be perceived by others.

#### *Identifying threats*

#### IDENTIFYING THREATS

13. Threats to compliance with the fundamental principles might be created when a PA accepts or offers inducements; for example:

- Self-interest threats might be created from the offering and accepting of inducements, as the inducement could be made with the ulterior intention of gaining an otherwise unavailable advantage.

Possible examples of a self-interest threat are:

- *A PA offers a gift or hospitality to an individual in order to persuade him or her to make a business decision, such as purchasing from a certain supplier that would directly or indirectly benefit the PA.*
- *A PA offers a gift to a colleague in order for him or her to accept a specific accounting position, such as an accounting treatment that influences the financial statements to the benefit of the employing organization which then indirectly also benefits the PA.*

- Familiarity threats might be created if the offering or accepting of an inducement results in the relationship between the PA and another individual, such as a vendor or customer, becoming too close, whether on a professional or personal level, and thus affecting the PA's professional judgement.

The frequency of the inducement would be a key factor in determining how the relationship between the PA and another individual is affected by the gift or hospitality. If the frequency is sufficient to make the relationship too close, it could impact, or might be perceived to impact, the objectivity of the PA.

A possible example of a familiarity threat is:

- *A PA regularly accepts complementary offers to attend sporting events with the other individual.*

- Intimidation threats might be created if the offering or accepting of an inducement is followed by threats to make that offer or acceptance public and damage the reputation of either the PA or an immediate or close family member.

A possible example of a familiarity threat is:

- *A PA accepts complementary tickets to an exclusive high profile event from an individual. After the event has concluded, the PA declines an inappropriate request from the individual. The individual then threatens to report the PA over acceptance of the tickets.*

#### EVALUATING THREATS

14. Where inducements are offered or accepted that are clearly trivial and inconsequential, the PA can generally conclude that any threats to compliance with the fundamental principles are at an acceptable level.
15. For all other inducements, the PA should use professional judgement to evaluate the threats to determine if they are at an acceptable level and, if necessary, apply safeguards where available. As part of this evaluation, the PA shall take into account whether a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances available to the PA at that time, that the threats are at an acceptable level, or the safeguards applied have reduced them to an acceptable level, so as not to compromise compliance with the fundamental principles.
16. The existence and significance of any threat will depend on various factors, including the following:
  - The value, frequency and nature of the inducement. Guidance should note that inducements accepted or offered on a regular basis, especially to or from the same party, could result in the PA becoming less mindful to the fact that such inducements, in totality, could create a threat.
  - The occasion that has given rise to the inducements, such as a religious holiday or wedding.
  - Whether the acceptance of the inducements can be directly associated with the conduct of business.
  - Whether the inducements is specific to an individual or available to a broader group. The broader group might be internal to the employing organization or external to the employing organization, such as other customers or vendors.
  - The roles and positions of the individuals offering and being offered the inducements.
  - The significance or materiality of the inducements to the individual(s) offering and being offered the inducements.
  - Policies and procedures of the employing organization of the individual offering or receiving the inducements.

#### ADDRESSING THREATS

17. Paragraphs R120.8–R120.8 A2 include requirements and application material for addressing threats. Safeguards vary depending on the facts and circumstances. Below are examples of actions that in certain circumstances might be safeguards in addressing threats:
  - Registering the inducements in a log.

- Consulting with senior management of the employing organization, those charged with governance or employing organizational policy, when an inducements is offered.
  - Consulting with a senior colleague or professional organization on the inducements.
  - Recusing from making any business-related decisions relating to the individual or organization, such as a customer or vendor, to whom the PA offered or accepted the inducements.
  - Secondary reviews of any work performed or decisions made by the PA with respect to the individual or organization from which the PA accepted or offered the inducements.
18. If the threat cannot be reduced to an acceptable level using safeguards, the PA shall not offer or accept the inducement.

*Relation to other sections in the Code*

19. A PA may also face pressure that could create threats, for example, intimidation threats, to compliance with the fundamental principles when undertaking a professional activity. In such situations Section 370 is also relevant.

## Appendix 2

### Project History

#### Project: Part C, Phase 2

#### Summary

	CAG Meeting	IESBA Meeting
Project commencement		March 2013
Development of proposed international pronouncement (up to exposure)	April 2013 September 2014	January 2015 April 2015