Discussion – The Public Interest as a Fundamental Principle?

Background

THE ISSUE

1. In December 2011, the IESBA issued its exposure draft (ED), *Proposed Changes to the Code of Ethics for Professional Accountants Addressing Conflicts of Interest*. The proposed changes provide more specific requirements and guidance for professional accountants in public practice or in business in applying the conceptual framework when identifying, evaluating, and managing conflicts of interest. The comment period closed on March 31, 2012. The Board will be considering the final proposals at this meeting with the aim of approving them as a final standard (see Agenda Item 3).

2. In responding to the ED, the International Organization of Securities Commissions (IOSCO) suggested that the IESBA explicitly recognize the concept of “public interest” as a fundamental principle in paragraph 100.5 of the Code, and then detail it in further provisions in the Code. Among other matters, IOSCO also:

- Suggested that auditors be required to avoid creating new conflicts of interests and, when dealing with conflicting interests, to give most weight to the public interest; and
- Urged the IESBA to reflect on the best possible way to reinforce the auditor’s responsibility to act in the public interest.

3. The relevant excerpts of IOSCO’s comment letter are included in Appendix A.

4. At the September 2012 IESBA Consultative Advisory Group (CAG) meeting, in the context of the discussion of the Conflicts of Interest project, some CAG Representatives expressed support for IOSCO’s suggestion that the public interest be recognized as a fundamental principle in the Code (see Agenda Item 3-D).

FUNDAMENTAL PRINCIPLES

5. Paragraph 5 of Section 100 of the Code sets out the fundamental principles as follows:

A professional accountant shall comply with the following fundamental principles:

(a) Integrity – to be straightforward and honest in all professional and business relationships.

(b) Objectivity – to not allow bias, conflict of interest or undue influence of others to override professional or business judgments.

(c) Professional Competence and Due Care – to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional services based on current developments in practice, legislation and techniques and act diligently and in accordance with applicable technical and professional standards.

(d) Confidentiality – to respect the confidentiality of information acquired as a result of professional and business relationships and, therefore, not disclose any such information to third parties without

1 Section 100, Introduction and Fundamental Principles
proper and specific authority, unless there is a legal or professional right or duty to disclose, nor use
the information for the personal advantage of the professional accountant or third parties.

(e) Professional Behavior – to comply with relevant laws and regulations and avoid any action that
discredits the profession.

CODE REFERENCES TO “PUBLIC INTEREST”

6. The Code also includes various references to the concept of public interest. Key references are
listed in Appendix B and include:

- A statement that accepting responsibility to act in the public interest is a distinguishing mark
  of the accountancy profession.
- A requirement to comply with the Code in order to serve the public interest.
- A statement that the conceptual framework approach assists professional accountants in
  acting in the public interest.
- The specific circumstances in which a professional accountant should consult a member
  body or regulator, if an outcome may not be in the public interest.

HANDBOOK REFERENCES TO “PUBLIC INTEREST”

7. Separately, the Handbook containing the Code emphasizes the IESBA’s objective of serving the
public interest and how aspects of its operating structure and processes, and its oversight, are
designed to enable the Board to achieve such objective, for example:

- Adherence to a rigorous due process.
- The inclusion of at least three non-practitioners who are public members, i.e., individuals who
  are expected to reflect, and are seen to reflect, the wider public interest.
- Oversight by the Public Interest Oversight Board (PIOB).
- The involvement of the Consultative Advisory Group (CAG) in the IESBA’s standard-setting
  process to provide public interest input into the development of the IESBA’s standards and
  guidance.

IFAC POLICY POSITION 5

8. The Code does not provide guidance on how a professional accountant should evaluate
circumstances for the benefit of the public interest. In June 2012, however, IFAC issued its Policy
Position 5, A Definition of the Public Interest. The paper aims to present a practical definition of
“public interest” that:

(a) Identifies the public interest; and

(b) Enables one to assess the extent to which actions, decisions, or policies are made in the
public interest.

9. The Policy Position is presented in Agenda Item 9-B. At the meeting, IFAC’s Chief Executive CEO,
Ian Ball, will present the paper.
10. In August 2012, the IESBA issued its ED, *Responding to a Suspected Illegal Act*. The ED aims to address:

- The process to follow when a professional accountant comes across a suspected illegal act; and
- When the accountant should override confidentiality and disclose the matter to an appropriate authority.

11. Under the ED, the professional accountant would be required to take reasonable steps to confirm or dispel the suspicion through discussion with the appropriate level of management. If the response is not appropriate, the professional accountant would be required to escalate the matter to higher levels of management and those charged with governance, as appropriate. If the response is still not appropriate, the ED would require disclosure of the matter to specified parties (for example, an appropriate authority in the case of an audit) if such disclosure would be *in the public interest*.

**APPROACH TAKEN BY OTHER STANDARD-SETTERS**

12. The 2010 revisions to the International Accounting Standards Board’s (IASB) and the US Financial Accounting Standards Board’s (FASB) Conceptual Frameworks represent the culmination of the first phase of a joint project between these two standard-setting boards to develop an improved common Conceptual Framework that provides a sound foundation for developing future accounting standards.

13. The Preface to the International Financial Reporting Standards issued by the IASB notes:

> The objectives of the IASB are to develop in the public interest, a single set of high quality, understandable, enforceable and globally accepted financial reporting standards based on clearly articulated principles.

14. The Preface to the FASB Statement of Financial Accounting Concepts No. 8 notes that the Conceptual Framework is:

> ... intended to serve the public interest [emphasis added] by providing a structure and direction to financial accounting and reporting to facilitate the provision of unbiased financial and related information.

15. The FASB’s Conceptual Framework also states that “individual primary users [of financial information] may have different and quite possibly conflicting information needs and desires.”

16. The Basis for Conclusions (Basis Document) accompanying the IASB/FASB 2010 revisions to their Conceptual Frameworks acknowledge that the interests of investors, lenders, and other creditors often overlap with those of regulators, but conflicts often arise. The Basis Document discusses the challenges of expanding the objective of financial reporting to, for instance, include financial stability. It notes the following:

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[E]xpanding the objective of financial reporting to include maintaining financial stability could at times create conflicts. For example, some may take the view that the best way to maintain financial stability is to require entities not to report or to delay reporting some changes in asset or liability values. That requirement almost certainly would result in depriving investors, lenders, and other creditors of information that they need. The Board concluded that eliminating that [reporting] objective would be inconsistent with its basic mission, which is to serve the information needs of participants in capital markets. The Board also noted that providing relevant and faithfully represented financial information can improve users’ confidence in the information and, thus, contribute to promoting financial stability.

17. Appendix C contains excerpts from the FASB’s SFAC 8 that elaborate on the different types of financial statement users and why general purpose financial statements will not meet all the different public interest needs.

Discussion

18. This session is an open discussion on the following matters, informed by the presentation on IFAC’s Policy Position 5 and the matters highlighted above.

(a) Whether the concept of the public interest should be recognized as a fundamental principle in the Code appears preconditioned on a definition of the term “public interest” being capable of first being established that would work for purposes of the Code.
   ➢ To what extent could IFAC’s Policy Position 5 be leveraged if the IESBA were to seek to establish such a definition?
   ➢ What would be the challenges or obstacles to attempting to establish such a definition?

(b) There is no provision in the Code to comply, or maximize the benefits associated, with only one aspect or part of a fundamental principle. A fundamental principle has either been adhered to, or not been applied. The notion of the public interest encompasses the interests of varied groups of individuals such as investors, lenders, creditors and regulators. Also, it may be influenced by cultural or societal norms.
   ➢ In the light of the above, would it be practicable to seek to establish the public interest as a fundamental principle, even assuming that a definition of “public interest” could be achieved for the Code?

(c) The IASB/FASB Conceptual Frameworks provides guidance on the types of users relying on financial information and how those users might assess financial information to fulfill their respective interests. The Frameworks include some discussion regarding whether the needs of financial statement users are being met.
   ➢ If it would not appear practicable to define the public interest or to seek to establish it as a fundamental principle, do IESBA members believe there would be benefit in developing guidance to the extent that there are issues in practice with respect to the application of this concept in the Code?
   ➢ In what other ways could the matter raised by IOSCO be addressed by the IESBA?

(d) The matter raised by IOSCO has tentatively been included as a possible item in the strategy survey on which to seek stakeholders’ views as to prioritization for purposes of the Board’s strategy and work plan for 2014-2016 (see Agenda Item 6-A).
In light of the Board discussion, do IESBA members believe the matter raised by IOSCO should be signaled as a possible item for the next strategic plan and therefore included in the strategy survey?

If not, would there be a different question related to the same matter that could be included in the strategy survey (e.g., consideration of whether guidance could be developed)?
Appendix A

Excerpt from IOSCO Comment Letter on Conflicts of Interest Exposure Draft

The Importance of the Public Interest

1. The notion of a “conflict of interest” seems to implicitly suggest that there may be various identifiable interests at play during the performance of services by a professional accountant. In our view, the overarching and most important interest is the public interest. We are concerned that the proposed revisions and more broadly, the Code of Ethics, may not sufficiently and explicitly guide the accountant to use the public interest as a benchmark for his/her behavior.

2. We note many instances in the Code where reference is made to the professional accountant’s general responsibility to use the public interest as a benchmark. We also noted, however, that the Fundamental Principles within paragraph 100.5 of the Code do not explicitly mention the accountant’s responsibility to act in the public interest. We believe that acting in the public interest would entail that the auditor functions in a manner that is consistent with and/or contributes above all other interests to the efficient and effective functioning of the securities markets, including providing the relevant information to the users/investors on a timely basis. As we believe the public interest is the overarching and most important interest, we think it should be made clear within the Code that the interest of the profession or clients should never trump or come at the expense of the public interest. We believe this should be a principle explicitly set out in Paragraph 100.5 of the Code. A general principle of this nature could then be detailed in some further provisions. We would for instance suggest that the auditor be required to avoid creating new conflicts of interest, and also that he would be required, when dealing with conflicting interests, to give most weight to the public interest.

3. And although we realize this is beyond the scope of the current project, we also note the IFAC Policy Position Paper #4 of 2011, as well as our comment letter dated May 4, 2011 in response of that paper. Particularly on page 5 of our letter, we reflected upon the responsibilities of professional accountants. In relation to IFAC’s efforts to define the public interest and the ongoing debate in many jurisdictions on the role of auditors, we urge the Board to reflect on the best possible way to reinforce the auditor’s responsibility to act in the public interest.

Conflicts of Interest Relating to the Public Interest

4. We note that the public interest may conflict with the interest of other parties. On the basis of the Exposure Draft, it is unclear whether the proposed changes to the Code of Ethics are also intended to deal with situations in which there is a conflict of the public interest with other interests. As we stated above, we believe that auditors are appointed to serve the public interest. There seems to be no guidance on how to deal with situations where the public interest conflicts with other interests. Given the likelihood of such conflicts to occur, we think it is important to provide guidance on how to deal with such conflicts. We therefore encourage the Board to clarify how public interest considerations should be dealt with when conflicts of interest emerge.
Key References to “Public Interest” Included in the Code

The Code includes the following key references to the concept of public interest:

1. Accepting responsibility to act in the public interest as a distinguishing mark of the accountancy profession:

   A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. Therefore, a professional accountant’s responsibility is not exclusively to satisfy the needs of an individual client or employer. [Paragraph 100.1]

2. A requirement to comply with the Code to serve the public interest:

   In acting in the public interest, a professional accountant shall observe and comply with this Code. If a professional accountant is prohibited from complying with certain parts of this Code by law or regulation, the professional accountant shall comply with all other parts of this Code. [Paragraph 100.1]

3. The conceptual framework approach assisting professional accountants in acting in the public interest:

   The conceptual framework approach assists professional accountants in complying with the ethical requirements of this Code and meeting their responsibility to act in the public interest. [Paragraph 100.6]

4. When a professional accountant should consult a member body or regulator, if an outcome may not be in the public interest:

   When a professional accountant encounters unusual circumstances in which the application of a specific requirement of the Code would result in a disproportionate outcome or an outcome that may not be in the public interest, it is recommended that the professional accountant consult with a member body or the relevant regulator. [Paragraph 100.11]
Appendix C


The excerpts below elaborate on the different types of financial statement users and why general purpose financial statements will not meet all the different public interest needs.

OB6. However, general purpose financial reports do not and cannot provide all of the information that existing and potential investors, lenders, and other creditors need. Those users need to consider pertinent information from other sources, for example, general economic conditions and expectations, political events and political climate, and industry and company outlooks.

OB7. General purpose financial reports are not designed to show the value of a reporting entity; but they provide information to help existing and potential investors, lenders, and other creditors to estimate the value of the reporting entity.

OB8. Individual primary users have different, and possibly conflicting, information needs and desires. The Board, in developing financial reporting standards, will seek to provide the information set that will meet the needs of the maximum number of primary users. However, focusing on common information needs does not prevent the reporting entity from including additional information that is most useful to a particular subset of primary users.

OB9. The management of a reporting entity also is interested in financial information about the entity. However, management need not rely on general purpose financial reports because it is able to obtain the financial information it needs internally.

OB10. Other parties, such as regulators and members of the public other than investors, lenders, and other creditors, also may find general purpose financial reports useful. However, those reports are not primarily directed to these other groups.

OB11. To a large extent, financial reports are based on estimates, judgments, and models rather than exact depictions. The Conceptual Framework establishes the concepts that underlie those estimates, judgments, and models. The concepts are the goal towards which the Board and preparers of financial reports strive. As with most goals, the Conceptual Framework’s vision of ideal financial reporting is unlikely to be achieved in full, at least not in the short term, because it takes time to understand, accept, and implement new ways of analyzing transactions and other events. Nevertheless, establishing a goal towards which to strive is essential if financial reporting is to evolve so as to improve its usefulness.