

**PROJECT PROPOSAL—REVIEW OF PART C OF THE CODE****I. Subject**

1. The provisions in Part C of the IESBA *Code of Ethics for Professional Accountants* (the Code) addressing professional accountants in business (PAIBs).

**II. Background and Relevant Developments**

2. In February 2012, the IESBA established a Working Group to study reported accounting irregularities at certain companies and determine whether Part C should be strengthened to better promote ethical behavior by PAIBs. In addition, Part C had received less attention than other parts of the Code in recent years and, therefore, the IESBA considered that a review of the Part C provisions would be timely.
3. To understand the ethical issues about which PAIBs contact their member bodies, the Working Group undertook in Q2 2012 a survey of a number of IFAC member bodies with large proportions of PAIBs in their memberships. This survey identified a list of issues for the IESBA's potential consideration. To prioritize the issues identified, the Working Group undertook in Q3 2012 a broader survey of IFAC member bodies.
4. On the basis of the input from those surveys as well as from the IESBA Consultative Advisory Group (CAG), the Working Group identified a number of key recommendations for a review of Part C that were presented at the December 2012 IESBA meeting. The IESBA agreed to the recommendations and commissioned the working group to prepare this project proposal.

(Included in this project proposal is a suggestion for the project to consider combining Part C with Part A, an idea that the Working Group has originated after the December 2012 IESBA discussion. This matter is discussed further in paragraphs 21-24 of this project proposal.)

**III. Project Objective and Scope, and How They Serve the Public Interest****Project Objective**

5. The objective of the project is to review Part C to ensure that its provisions remain appropriate and are robust.

**Project Scope**

6. The scope of the project encompasses Part C and its relationship with other parts of the Code.

**How the Project Serves the Public Interest**

7. Over half of the world's professional accountants are PAIBs in the traditional sense – being accountants who do not work in public accounting practices. PAIBs are a very diverse constituency, and work as employees or consultants in commerce, industry, financial services, education, and the public and not-for-profit sectors. Many are in a position of strategic or functional leadership, or are otherwise well-placed to collaborate with colleagues in other disciplines to help their organizations toward long-term sustainable success.

8. The project will serve the public interest as a result of those provisions of the Code applicable to PAIBs being appropriate and robust, given that many PAIBs play a fundamental role in the financial reporting supply chain and facilitate effective governance in organizations. In particular, enabling PAIBs to better deal with the issue of inappropriate pressure on them, particularly with respect to the preparation and reporting of information, will contribute to the public interest because such pressure may undermine the quality of financial information on which users rely. In addition, addressing the issue of bribery as encountered by PAIBs would help to strengthen the development of economies and support confidence in markets.

## IV. Outline of the Project

### Issues that will be addressed and Approach to Project

9. In December 2012, the IESBA supported the Working Group's recommendations to address a number of issues in Part C of the Code. The Working Group proposes that all the key issues it had identified should be addressed as one project as they are inter-related. However, the Working Group proposes that the issues be dealt with in two separate phases as follows:

#### Phase One

- Section 300, *Introduction*
- Those parts of Section 310 which were deleted in the Conflicts of Interest project but which remain relevant to "pressure"
- Sections 320, *Preparation and Reporting of Information*
- Section 330, *Acting with Sufficient Expertise*
- Section 340, *Financial Interests*

#### Phase Two

- Section 350, *Inducements*

#### *Section 340*

10. Consideration should be given to whether the motivations of PAIBs as addressed in Section 340 should be expanded beyond financial interests. These motivations are closely linked to the pressure to act inappropriately in Section 320, and in extant Section 310 (which will be replaced by the revised provisions on conflicts of interest). Dealing with these motivations under one heading related to pressure may make the Code clearer. This could include threats and safeguards to help the PAIB who is being pressured to act inappropriately by those in a superior position.
11. A senior PAIB may pressure a subordinate in relation to an accounting irregularity. Paragraph 300.5 refers to the importance of encouraging an ethics-based culture, but there is no other requirement for a senior PAIB not to inappropriately pressure subordinates. Consideration should be given to whether the Code should require a senior PAIB not to inappropriately pressure subordinates.

Section 320

12. Parts A and C make only a brief mention of the PAIB's responsibility to prepare financial statements. The Code mentions a PAIB's responsibility to provide information that provides a "faithful representation" in three places:
  - 320.1: "A professional accountant in business shall prepare or present such information fairly, honestly and in accordance with relevant professional standards so that the information will be understood in its context;"
  - 320.2 states that financial reports shall be prepared in accordance with applicable financial reporting standards; and
  - Indirectly in paragraph 110.1: "Integrity also implies fair dealing and truthfulness."
13. Consideration should be given to whether more guidance should be provided to PAIBs on their responsibility with regard to the preparation or presentation of financial statements that present a faithful representation. The project could explore a revised principles-based section structured as follows:
  - (a) A more positive and fuller statement of the responsibility of PAIBs to prepare and report information that is a faithful representation of economic events and state of affairs;
  - (b) A discussion of the threats to providing such depictions (including the motives for altering or manipulating the information); and
  - (c) Presentation of safeguards.
14. The need to build on, but not overlap with, the work of accounting standard setters, including the International Public Sector Accounting Standards Board (IPSASB), is recognized. While PAIBs may find it helpful to have further guidance on concepts such as "fairly and honestly" and "earnings management," the difficulty in developing such guidance is recognized.
15. Consideration should be given to reviewing the wording in paragraphs 320.1 and 320.2 and clarifying:
  - The intent of the apparent dual requirement that information be prepared or presented fairly and honestly and in accordance with relevant professional standards.

A PAIB has a responsibility to prepare financial statements in accordance with relevant professional standards and use professional judgment in determining that the information will be understood in the context in which it is presented. Circumstances may exist where financial reporting standards allow a presentation that does not reflect the economics of the transaction and may thus be misleading. International Financial Reporting Standards (IFRS) allow a management override and other frameworks may also allow an override. It would be helpful to clarify whether PAIBs are required to do something more than present information in accordance with relevant professional standards if application of a standard would result in a portrayal of, for example, the financial position and results of operations that are not fair and honest in the circumstances.
  - Whether and, if so, how the "relevant professional standards" in paragraph 320.1 are intended to differ from the "applicable financial reporting standards" in paragraph 320.2 and if no difference is intended, to consider deleting one or the other.

16. The Code addresses a PAIB's responsibility not to be associated with misleading reports in paragraph 320.6. It is unclear how a PAIB should dissociate from misleading reports, either internal or external, other than by resigning. Consideration should therefore be given to providing guidance on how a PAIB can practically dissociate from misleading reports.
17. Consideration should also be given to exploring whether it is possible to describe or define earnings management in Section 320 to provide guidance to PAIBs.

*Sections 300 and 330*

18. Although no significant issues were identified in relation to Sections 300 and 330, consideration should be given to whether any changes to these sections should be made.

*Application of Part C to All Professional Accountants*

19. Paragraphs 100.3 and 100.12 state that professional accountants in public practice may also find Part C relevant to their particular circumstances. Therefore, they may be bound by the requirements of Part C as well as Parts A and B. However, the Code provides no guidance or explanation of the applicability of Part C to professional accountants in a firm that provides professional services, whether as employees or in another capacity.
20. One example of this is that professional accountants in public practice may be inappropriately pressured by superiors to compromise audit quality by working within unrealistic time budgets or to act inappropriately in other ways, which are not addressed in Part B. Such a situation may fall under the category of undue pressure by superiors which would be addressed by a review of Section 340. Another example might be where one division of a firm is pressured by another division of the firm to retain an untrustworthy client, solely to protect the larger fee income of the latter division. Or a firm's internal accounting staff might be pressured to massage the firm's results so that profit shares for partners are distorted towards one individual or group of partners. Essentially all of the problems that traditional PAIBs face can also arise inside accounting firms, with the same ethical dilemmas for those employees and partners.
21. Professional accounting firms are commercial businesses and therefore professional accountants working in them as partners or staff could be interpreted as falling within the Code's definition of a PAIB:

A professional accountant employed or engaged in an executive or non-executive capacity in such areas as commerce, industry, service.

Part C may therefore be applicable to all professional accountants.

22. Accordingly, consideration should be given to whether Part C could be consolidated within Part A, including exploring how this would be perceived by stakeholders, especially member bodies. For example, consideration should be given to whether consolidating Part C with Part A may be perceived as making the Code less relevant to PAIBs and therefore less effective. Alternatively, consideration should be given to leaving Part C as a stand-alone section but proposing the inclusion within Part A of certain Part C requirements.
23. It is noted that if Part C were to be consolidated with Part A, doing so may have implications for auditors and therefore be of interest to the IAASB.

24. Also, if the IESBA were to consider that there would be merit in consolidating Part C with Part A, consideration should be given to whether this could be accomplished in conjunction with the Code Restructuring initiative.

*The Role of the PAIB Within an Organization*

25. At its meeting in December 2012, the IESBA considered how the professional accountant applies the Code in a working environment, where they may be part of a team. The individual PAIB can influence but often cannot mandate a certain course of action for the PAIB's organization. The Code is written for the individual professional accountant, although the definition of professional accountant in public practice includes the firm. Consideration should be given to the practical implications of the PAIB operating in a working environment, including:
- Circumstances where the Code is inconsistent with the employer's code or the professional code of a colleague;
  - Working with colleagues who are not subject to the Code. This can include CFOs and other senior and junior finance staff who are not professional accountants, multi-disciplinary groups and other non-finance staff;
  - The role of the PAIB in encouraging their employer to have an ethics code.
26. Many PAIBs work outside the remit of accountancy-related areas (financial reporting, financial management, taxation, treasury, internal audit), for example, as CEOs, independent directors, bankers, venture capitalists. Consideration should be given to clarifying whether and how Part C applies to professional accountants who work outside accountancy.

*Section 350*

27. Section 350 concerns PAIBs receiving offers and making offers. Facilitation payments and bribes are a challenging and perennial problem area for PAIBs, especially in the context of an international code of ethics and for organizations operating across jurisdictional and cultural boundaries. The description of an inducement in paragraph 350.1 is wide ranging but does not refer to "facilitation payments" or bribery. While most legislation is believed to focus on inappropriate payments (on which all survey respondents' comments have also focused), Section 350 is focused on "receiving offers." "Making offers" has less prominence in Section 350. Section 350 prohibits a PAIB from offering an inducement. However, the Code does not currently address the situation of the PAIB who becomes aware of a bribe made by others. Although the section on receiving offers lists safeguards, a PAIB is thought to be more likely to encounter the making of offers.
28. Consideration should therefore be given to whether additional guidance could be provided to assist the PAIB when encountering the making of offers within the employing organization. Consideration should also be given to how this might overlap with the IESBA's current project on responding to a suspected illegal act.
29. Separately, the working group noted a lack of symmetry between Section 350 and Section 260 (Gifts and Hospitality) in Part B. Consideration should therefore be given to revisiting Section 260 if changes are made to Section 350.
30. Consideration should also be given to whether additional guidance that recognizes the diversity of cultures would be helpful to PAIBs working across different cultures and jurisdictions.

### **Impact Analysis Considerations**

31. Changes to Part C are not expected to impact regulators as PAIBs are not normally regulated. However, consideration should be given to making inquiries regarding the views of regulators on proposed changes to the guidance on financial reporting, pressure and bribery.
32. There would likely be implementation costs at the national level if Part C were to be changed. This is particularly true if Part C were to be incorporated into Part A.
33. Individual PAIBs may be impacted by changes to Part C. It is anticipated that the impact will be positive by providing more guidance to PAIBs in dealing with ethical issues that the Working Group's surveys have shown to be important to them.
34. If Part C were incorporated into Part A, there may be requirements on professional accountants in public practice which previously only applied explicitly to PAIBs.
35. Further consideration of impact will be an important part of the IESBA's evaluation of proposals. IFAC is currently developing an impact analysis framework for the standard-setting bodies that it supports.

### **V. Implications for any Specific Persons or Groups**

36. The project has particular implications for IFAC member bodies that have adopted the Code, or use it as a basis or a benchmark for their own ethical standards.
37. There may be implications for PAIBs working in all sizes of businesses and in the public sector. IFAC's PAIB Committee, the IPSASB and the IFAC Small and Medium Practices (SMP) Committee will be kept apprised of developments to ensure appropriate input is received at key stages of the project.
38. If Part C were to be consolidated with Part A, that may have implications for the IAASB. This may also have implications for the IESBA Working Group considering a restructuring of the Code.
39. When considering the provisions of the Code that apply to the preparation and reporting of information, consideration will be given to liaison with the accounting standard setters as appropriate, such as IASB and IPSASB, to build on but not overlap with their work.
40. The definition of PAIB includes professional accountants working in diverse environments, including, in addition to commerce and industry:
  - Public sector, e.g. central government, local government;
  - Not for profit sector;
  - Education; and
  - Regulatory and professional bodies.

Consideration should be given to the different threats and safeguards which may apply to PAIBs working in different sectors. In addition, threats and safeguards may differ amongst different cultures and sizes of enterprises.

## VI. Development Process, Project Timetable and Project Output

### Development Process

41. It is anticipated that the project will follow the normal development process of the IESBA if it concludes that changes to the Code are required.
42. The project approach will include appropriate dialogue with member bodies or others able to influence ethical standards in this area so that, to the extent possible, consistent requirements and guidance are developed.

### Project Timetable

43. Subject to the IESBA's approval of the project proposal, this project will commence immediately. The specific project milestones and outputs will be dependent on the matters that the project Task Force ultimately determines are appropriate to address as part of the project, and the priorities assigned to those matters.

Indicative Timing	Milestone
March 2013	Approval of project proposal
September 2014	Approval of consultation document (nature to be determined by project Task Force) (Phase 1)
Ongoing	Dialogue with stakeholders on key issues and proposals <sup>1</sup>

### Project Output

44. The output of the project may take the form of additional or revised requirements and guidance in the Code.

## VII. Resources Required

45. A project Task Force will be established, consisting of four or five individuals, including an IESBA member as Chair.
46. Consideration will also be given as to how best to obtain appropriate input from other stakeholders who have similar projects (in particular, PAIB Committee). This may be through membership on the project Task Force, correspondent membership, or by other means.
47. IESBA Staff will provide support to the project Task Force.

## VIII. Relevant Sources of Information that Address the Matter Being Proposed

48. Relevant sources of information include:
  - Ethical requirements for PAIBs implemented by member bodies and similar.

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<sup>1</sup> To include discussion with the IESBA CAG

## Appendix

### Comments by IFAC Technical Managers

The comments of IFAC Technical Manager from each technical area are required before this Project Proposal is considered by the board or committee proposing to undertake the project.

#### **Technical Manager to the Compliance Advisory Panel and Professional Accountancy Organization Development Committee**

I support the objectives of the project proposal, in particular as they relate to providing more robust guidance to PAIBs. I believe this project needs to be closely related to the considerations on restructuring the Code and result in clear and concise codification of (a) key principles that are easy to understand and internalize, and (b) additional guidance that can assist in understanding the principles and applying them in PAIBs work and life.

One of the key values of the IFAC Compliance Program relates to understanding and appreciation of differing regulatory frameworks, national environments, cultures and stages of development of PAOs around the world. Therefore, we also welcome specific references to the planned considerations of IESBA related to the cultural and environmental differences that the new / revised guidance should include.

Signed: Szymon Radziszewicz

Date: February 20, 2013

#### **Technical Manager to the International Accounting Education Standards Board (IAESB)**

I have read the proposal and agreed with the aim and purpose of the project. The proposed project proposal for the Review of Part C of the Code, as indicated above, is not expected to have a direct impact on the IAESB's current work plan, on the IAESB's work to revise its International Education Standards, or on the IAESB's work to provide implementation guidance for the revised standards.

Signed: David McPeak

Date February 20, 2013

#### **Technical Manager to International Auditing and Assurance Standards Board (IAASB)**

The references in paragraphs 23 and 38 regarding the possibility of consolidating Part C with Part A have been noted. I encourage IESBA staff to apprise IAASB staff on issues as they develop and, together, to ascertain at an appropriate stage the nature of further specific interactions between IAASB and IESBA that may be necessary.

Signed: James Gunn

Date: February 27, 2013

#### **Technical Manager to the Professional Accountants in Business (PAIB) Committee**

The response to the proposed PAIB Strategy and Work Plan 2013-16 strongly supported the PAIB Committee to work more closely with IESBA in its review of Part C.

Signed: Stathis Gould/Vincent Tophoff

Date: February 19, 2013

**Technical Manager to the International Public Sector Accounting Standards Board**

No comment.

Signed: Stephenie Fox

Date: February 20, 2013

**Technical Manager to the Small and Medium Practices Committee**

This project is of significant relevance to us given that it has the potential to impact individual SMPs in their interactions with professional accountants working in their practice and those working for clients. The project will also likely have implications for how the IESBA Code is best structured. We support the project and would appreciate being kept abreast of developments and hope that SMPs and PAIBs working in SMEs are well represented on the Task Force.

Signed: Paul Thompson

Date: February 14, 2013

**Technical Manager to the Transnational Auditors Committee (TAC)**

We are supportive of this project though suspect that the current environment may give greater focus to other recent project proposals we've reviewed. PAIBs should be required to comply with ethical requirements – the absence of which would seemingly impact audit risk assessments.

Signed: Barry Naik

Date: February 22, 2013