

## **ICAP comments on IESBA Exposure Draft ‘Proposed Changes to Part C of the Code Addressing Presentation of Information and Pressure to Breach the Fundamental Principles’**

### **SPECIFIC COMMENTS**

#### **Proposed Revised Section 320 ‘Presentation of Information’**

##### **Question 1**

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

##### **Answer 1**

Yes, the enhanced guidance on applying the “fair and honest” principle in Section 320 is helpful.

The improved presentation and provision of complete information for avoidance of any misrepresentation and adherence to relevant reporting framework will provide useful basis for decision-making and reduces probability of unintended consequences on financial stability. It may be said that the enhanced guidance on applying the “fair and honest” principle in Section 320 appears to be a possible path where objectives of management and other users of financial and non financial information are upheld and the goal of financial stability is also addressed.

##### **Question 2**

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

##### **Answer 2**

We support the guidance in paragraph 320.3 addressing the issue of misuse of discretion in a manner that is intended to mislead.

We would also like to include some examples in Section 320 in order to give PAIBs a clear thought regarding the areas where discretions may be misused and how:

- Long-term construction contracts require estimates of progress toward completion and costs to complete. Managers could use optimistic estimates of progress toward completion to inflate earnings.
- Depreciation computations require estimates of useful lives and salvage values. Managers could use favorable estimates of the life and salvage value of depreciable assets, reducing depreciation expense.
- Accounts receivable must reflect actual recoverability. Managers could use optimistic estimates of collectability to overstate earnings.
- Gains on disposal of assets be fully recognized in the period of sale. Managers could time the sale of appreciated assets to bolster earnings.
- Companies producing intangible assets must estimate the point at which technological feasibility and other relevant recognition criteria are met and thereafter capitalize the intangible asset. Managers could accelerate this date to avoid immediately expensing some costs.
- Anticipated costs of satisfying warranty obligations must be accrued and matched to revenues. By making optimistic estimates of product warranty costs, managers could reduce current expenses.
- Ordinary repairs are expensed as incurred, while major repairs are capitalized. By treating ordinary repairs as major repairs, managers could manipulate current earnings.
- Inventories must be stated at the lower of cost or net realizable value. Managers could use optimistic market values, resulting in reduced inventory write-downs.

**Question 3**

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

**Answer 3**

The guidance is sufficient. However, further guidance could be added to set a standard of acceptability:

The professional accountant shall prepare or present fairly and honestly such information that does not have to comply with a relevant reporting framework, in such manner and in given circumstances that any knowledgeable third party of his equivalent professional competence (e.g., an independent professional accountant) could determine independently that fundamental principles have not been breached.

**Question 4**

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

**Answer 4**

PAIB may rely on the work of others in order to effectively perform their duties. In such a case, it is necessary to take reasonable steps for satisfaction of the fact that such work has also been performed with the principle of honesty and fair play.

**Question 5**

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

**Answer 5**

The need to adhere to ethical value as proposed in paragraphs 320.6 and 320.7 regarding disassociation with misleading information is necessary.

However, monitoring of professional work including disciplinary proceedings and separate review and reporting of key matters may be additional actions to cater the threat of association with misleading information. We would also suggest that classified detailed guidance should also be provided to deal with two situations:

- a) Action where the misleading information has not yet been issued to the users.
- b) Action where the misleading information has already been issued to the users.

As regards 320.7, the fact needs to be understood that being an employee of the organization it would be extremely difficult for him to communicate to third parties, more particularly in the absence of any legal backing in the jurisdiction in which he is working. In our opinion, the Professional Accountant can at best communicate to those charged with the governance and the relevant professional body and could resign from the job.

**Proposed Section 370 'Pressure to Breach the Fundamental Principles'**

**Question 1**

Do respondents agree with the overarching requirements in paragraphs 370.1 and 370.2?

**Answer 1**

PAIBs must remain impartial and loyal to ethical guidelines while performing their duties. They should remain vigilant to deal with pressures to perform and help the company succeed as well as personal temptations to take the easy way out.

We agree with the requirement given in 370.1. For 370.2 “pressure on others” should be modified as “pressure on subordinates and others” to be more specific.

**Question 2**

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

**Answer 2**

Illustrative examples of types of pressure that could result in a breach of the fundamental principles in paragraph 370.4 are very helpful as PAIBs are likely to face many quandaries in their professional careers.

**Question 3**

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

**Answer 3**

Section 370 sufficiently addresses pressure that could result in a breach of fundamental principles, as opposed to the routine pressures that exist in the workplace. Paragraph 370.5 provides sufficient guidance to assist the PAIB in making that distinction, Except, in case of the last bullet of 370.5, where it would be difficult for an employee to consult the regulator.

Moreover, professional accountant may also consider referring past precedents about other companies facing similar dilemmas which may provide further insight about how to deal in such a situation.

**Question 4**

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

**Answer 4**

The guidance given in paragraph 370.6 is very helpful as these provide a course of action to PAIBs to defend themselves against breach of the fundamental principles.

**Question 5**

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

**Answer 5**

The cross references to other sections of Part C of the Code, in paragraph 370.9, are helpful as it relates fundamental ethical principles to their relevant guidance on pressures to breach them.

**OTHER COMMENTS:**

- 1- ISA-540 places substantial requirements on the external auditors to review the judgements and decisions made by management in making of accounting estimates to identify whether there are indicators of possible management bias. Similarly, IFRS-13 places requirements for the management who are primarily liable for such judgments and decisions of which the Professional Accountant in Business is an integral part. Nowhere in the Code, this important duty of the Professional Accountant has been re-emphasized to give further strength to the ethical principle except that the PAIB is bound to present the financial information in accordance with the identified financial reporting framework.

- 2- In code 370.7, the professional accountant may also be advised to change the nature of his job/assignment within the organization if practicable instead of taking extreme step of resigning from the job.

## **GENERAL COMMENTS**

- (a) Preparers (including Small and Medium Entities), and users (including regulators)—The IESBA invites comments on the proposed changes from preparers (particularly with respect to the practical impacts of the proposed changes), and users.

Preparers include both Small and Medium Entities and regulators. Practical impacts of each are explained below:

**Small and Medium Entities (SMEs):** In SMEs values and ethical principles are implicit rather than formally designed ethics policies, codes and programs. These do not have enough resources to introduce formal ethics offices, provide extensive training to staff, hire professionally trained accountants and the like. Considering these, the proposed changes of fair and honest principle, avoidance of misuse of discretion, disassociation with misleading information and not to pressure others and be pressurized by others seems to be difficult in SMEs.

Nevertheless, SMEs are influenced by its owners. They can help to set the ethical tone for their SMEs by talking about potential issues regarding fair and honest principle and challenges faced in pressure to breach fundamental principle situations. Leader themselves can set a good example of fair and honesty and giving potential signals to employees of how seriously ethical behavior is to be taken in the organisation.

The pressure on PAIB working in SMEs is more aggressive than that in a large entity due to difference in ethical environment. The code is silent on this.

**Regulators:** fundamental principles of fair and honest presentation of information and avoidance of pressures to breach fundamental ethical principles will result in transparency and clarity of information to users of financial statement.

- (a) PAIBs working in the public sector— Recognizing that many PAIBs work in the public sector, the IESBA invites respondents from this constituency to comment on the proposed changes, and in particular, on their applicability and usefulness in a public sector environment.

And

- (b) Developing Nations—Recognizing that many developing nations have adopted or are in the process of adopting the Code, the IESBA invites respondents from these nations to comment on the proposals, and in particular, on any foreseeable difficulties in applying them in their environment.

Despite of the fact that Pakistan is a developing country that has faced decades of social and political instability, the business sector of Pakistan is persistently striving to become more and more ethically compliant specifically ICAP and its members follow high standards of ethics in their professional affairs. A PAIB in Pakistan, however, may face certain difficulties in applying the ethical principles due to the environmental pressures. Nevertheless, the proposed guidelines will assist that PAIB in adopting a more ethical and professional approach towards the resolution of ethical dilemmas.